DOCKET

SUPREME COURT
OF THE UNITED STATES

No. 11-1085
Title: Amgen Inc., et al., Petitioners
v.
Connecticut Retirement Plans and Trust Funds
Docketed: March 5, 2012
Lower Ct: United States Court of Appeals for the Ninth Circuit
Case Nos.: (09-56965)
Decision Date: November 8, 2011
Rehearing Denied: December 28, 2011
Questions Presented

~~Date~~~	~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~~
Mar 1 2012	Petition for a writ of certiorari filed. (Response due April 4, 2012)
Mar 26 2012	Order extending time to file response to petition to and including May 4, 2012.
Apr 4 2012	Brief amici curiae of Former SEC Commissioners, et al. filed.
Apr 4 2012	Brief amici curiae of Washington Legal Foundation, et al. filed.
Apr 4 2012	Brief amicus curiae of Chamber of Commerce of the United States of America filed.
May 2 2012	Order further extending time to file response to petition to and including May 11, 2012.
May 11 2012	Brief of respondent Connecticut Retirement Plans and Trust Funds in opposition filed.
May 21 2012	Reply of petitioners Amgen Inc., et al. filed.
May 22 2012	DISTRIBUTED for Conference of June 7, 2012.
May 31 2012	Letter and attachment of respondent Connecticut Retirement Plans and Trust Funds filed. (Distributed)
Jun 4 2012	Letter of petitioner Amgen Inc., et al. in response filed. (Distributed)
Jun 11 2012	Petition GRANTED. Justice Breyer took no part in the consideration or decision of this petition.
Jun 21 2012	The time to file the joint appendix and petitioners' brief on the merits is extended to and including August 8, 2012.
Jun 21 2012	The time to file respondent's brief on the merits is extended to and including September 20, 2012.
Jul 16 2012	Motion to dispense with printing the joint appendix filed by petitioners Amgen Inc., et al.
Jul 23 2012	SET FOR ARGUMENT ON Monday, November 5, 2012
Jul 25 2012	Consent to the filing of amicus curiae briefs, in support of either party or of neither party, received from counsel for the petitioners.
Aug 2 2012	Record recieved from U.S.C.A. for 9th Circuit. (1 box)
Aug 3 2012	Record recieved from U.S.D.C. for Central District of California. (2 boxes)

Aug 8 2012	Brief of petitioners Amgen Inc., et al. filed.
Aug 13 2012	Motion to dispense with printing the joint appendix filed by petitioners GRANTED. Justice Breyer took no part in the consideration or decision of this motion.
Aug 13 2012	Consent to the filing of amicus curiae briefs in support of either party or neither party received from counsel for the respondent.
Aug 14 2012	Brief amici curiae of Law Professors filed.
Aug 15 2012	Brief amici curiae of Washington Legal Foundation, et al. filed.
Aug 15 2012	Brief amici curiae of Chamber of Commerce of the United States of America, et al. filed.
Aug 15 2012	Brief amici curiae of Former SEC Commissioners, et al. filed.
Aug 15 2012	Brief amicus curiae of Securities Industry and Financial Markets Association filed.
Aug 24 2012	CIRCULATED.
Sep 20 2012	Brief of respondent Connecticut Retirement Plans and Trust Funds filed. (Distributed)
Sep 27 2012	Justice Breyer is no longer recused in this case.
Sep 27 2012	Brief amicus curiae of the United States filed. (Distributed)
Sep 27 2012	Brief of National Association of Shareholder and Consumer Attorneys filed. (Distributed)
Sep 27 2012	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
Sep 27 2012	Brief amicus curiae of Public Justice, P.C. filed. (Distributed)
Sep 27 2012	Brief amici curiae of Civil Procedure and Securities Law Professors filed. (Distributed)
Sep 27 2012	Brief amicus curiae of AARP filed. (Distributed)
Sep 27 2012	Brief amici curiae of New York City Pension Funds, et al. filed. (Distributed)
Sep 27 2012	Brief amicus curiae of Public Citizen, Inc. filed. (Distributed)
Sep 27 2012	Brief amici curiae of Financial Economists filed. (Distributed)
Sep 27 2012	Brief amici curiae of California Public Employees' Retirement System, et al. filed. (Distributed)
Oct 15 2012	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
Oct 22 2012	Reply of petitioners Amgen Inc., et al. filed. (Distributed)
Nov 5 2012	Argued. For petitioners: Seth P. Waxman, Washington, D. C. For respondent: David C. Frederick, Washington, D. C., and Melissa Arbus Sherry, Assistant to the Solicitor General, Department of Justice, Washington, D. C. (for United States, as amicus curiae.)

PETITION FOR WRIT OF CERTIORARI

No. 11-1085

IN THE

Supreme Court of the United States

AMGEN INC., KEVIN W. SHARER, RICHARD D. NANULA, ROGER M. PERLMUTTER, GEORGE J. MORROW,
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether, in a misrepresentation case under SEC Rule 10b-5, the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory.

2. Whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

CORPORATE DISCLOSURE STATEMENT

Amgen Inc. does not have a parent corporation, and no publicly-held company owns 10% or more of Amgen Inc.'s stock.

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IN THE

Supreme Court of the United States

No. 11-

AMGEN INC., KEVIN W. SHARER, RICHARD D. NANULA, ROGER M. PERLMUTTER, GEORGE J. MORROW,
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

Petitioners Amgen Inc., Kevin W. Sharer, Richard D. Nanula, Roger M. Perlmutter, and George J. Morrow ("Amgen") respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. 1a-13a) is reported at 660 F.3d 1170. The opinion of the district court granting respondent's motion for class certification (App. 15a-50a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on November 8, 2011. A timely petition for rehearing en banc was denied on December 28, 2011. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES, REGULATIONS, AND RULES INVOLVED

Pertinent portions of the following statutory, regulatory, and rule provisions are reproduced in the appendix to this petition: Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78t(a) (App. 53a-54a); Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (App. 55a); and Federal Rule of Civil Procedure 23 (App. 56a-57a).

STATEMENT

To prevail in a private action alleging a misrepresentation in violation of Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, a plaintiff must prove reliance on the alleged misrepresentation. In *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), this Court recognized that plaintiffs could not proceed with a class action if they were required to prove direct individual reliance on the misrepresentation by each class member, because individual questions would overwhelm common ones. The Court, however, endorsed a rebuttable presumption of reliance by every class member in cases where the fraud-on-the-market theory applies. The theory is that if a security trades in an efficient market, all public material information is reflected in the price of the security. Purchasers or sellers who rely on the integrity of that market price therefore also rely, indirectly, on any material misrepresentations, which would be reflected in that price. The Court also

held that the presumption of reliance can be rebutted by "[a]ny showing that severs the link between the alleged misrepresentation" and "the price received (or paid) by the plaintiff." *Id.* at 248.

Under this Court's decisions, a plaintiff must demonstrate at the class certification stage that certain predicates to the fraud-on-the-market theory have been satisfied, including that the market for the security is efficient, that the alleged misrepresentation was public, and that the plaintiff traded the shares "between the time the misrepresentations were made and the time the truth was revealed." *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179, 2185 (2011) (quoting *Basic*, 485 U.S. at 248 n.27). The courts of appeals are split, however, on the question whether plaintiffs must also prove, for class certification, an additional predicate to the fraud-on-the-market theory—that the alleged misrepresentation was material. The courts of appeals also are split on the related question whether a defendant may, at the class certification stage, present evidence rebutting the applicability of the fraud-on-the-market theory.

In this case, the Ninth Circuit deepened these existing splits, joining the Seventh Circuit in wrongly excusing plaintiffs from any showing of the materiality predicate and refusing defendants an opportunity to present rebuttal evidence on that issue at the class certification stage. Given the well-recognized *in terrorem* power of class certification to force settlements of even non-meritorious securities fraud complaints, *see, e.g.*, *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740 (1975), the likely effect of the Ninth Circuit's rule is that, as a practical matter, defendants will rarely be able to test the materiality predicate to the fraud-on-the-market theory, notwithstanding the central impor-

tance of that theory in enabling class certification in the first place. The Ninth Circuit's decision is wrong and should be reversed.

1. Respondent Connecticut Retirement Plans and Trust Funds is the lead plaintiff in this action brought under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78j(b), 78t(a) (App. 53a-54a)) and Rule 10b-5 (17 C.F.R. § 240.10b-5 (App. 55a)). Respondent alleges that Amgen made misrepresentations regarding the safety of two of its products, Aranesp® and Epogen®, causing the artificial inflation of the market price for Amgen stock. App. 16a. Aranesp and Epogen are erythropoiesis-stimulating agents (ESAs), which stimulate the production of red blood cells and thus reduce the need for patient transfusions. Pet. C.A. Br. 6. Respondent alleges that Amgen made misrepresentations about the subject matter of a May 2004 FDA advisory committee meeting, clinical trials involving Aranesp, the safety of on-label uses of Aranesp and Epogen, and the marketing of the two drugs. App. 17a-20a.

2. Respondent moved to certify a class of persons who purchased Amgen stock from April 22, 2004 through May 10, 2007. App. 16a. The start of the period corresponds to a public statement by Amgen regarding a May 2004 FDA advisory committee meeting. Respondent alleges that Amgen misrepresented that the meeting would not focus on the safety of Aranesp. App. 17a. The end of the class period corresponds with a later meeting of the same FDA committee. Respondent alleges that that meeting constituted a corrective disclosure, revealing information about the safety of ESAs, including Aranesp and Epogen. App. 19a.

Respondent sought class certification pursuant to Federal Rule of Civil Procedure 23(b)(3) (App. 22a), which requires, among other factors, that "questions of law or fact common to class members predominate over any questions affecting only individual members." As with most misrepresentation claims under Rule 10b-5, the "predominance" inquiry in this case "turn[ed] on the element of reliance." *Erica P. John Fund*, 131 S. Ct. at 2184; App. 31a-34a. Respondent asserted that the putative class members were entitled to a common presumption of reliance based on the fraud-on-the-market theory. App. 31a. In support, respondent submitted expert evidence to establish the efficiency of the market for Amgen stock. App. 40a. Respondent made no similar evidentiary showing, however, about the materiality of Amgen's alleged misstatements. App. 33a-34a.

3. Amgen opposed class certification principally on the ground that respondent did not, and could not, establish that the alleged misrepresentations were material. App. 8a. To the contrary, Amgen showed through analyst reports and public documents that the market was aware of all the information respondent claimed Amgen had concealed through alleged misrepresentations during the class period. Pet. C.A. Br. 2, 8-9. Proof of market efficiency alone, Amgen argued, without any corresponding proof of the materiality of the alleged misrepresentations, was not sufficient to invoke a presumption of class-wide reliance based on the fraud-on-the-market theory. App. 32a.

Amgen also sought affirmatively to rebut any such presumption, again by showing that the market already was "privy to the truth," and accordingly that no alleged misrepresentation had any impact on the price of Amgen stock. *Basic*, 485 U.S. at 248; App. 41a. For

example, respondent claimed that the class period started when an Amgen executive purportedly stated that an upcoming May 2004 FDA advisory committee meeting would not focus on the safety of Aranesp.[1] App. 17a. Amgen demonstrated, however, through numerous analyst reports and public documents before and after the advisory committee meeting, that analysts were well aware that the committee would discuss possible safety concerns associated with Aranesp. Pet. C.A. Br. 9-10. The public documents included the agenda of the meeting itself, which was published in the Federal Register more than a month in advance of the meeting. App. 41a-42a. Amgen made similar showings regarding the other alleged misrepresentations. App. 42a-43a. Based on this rebuttal evidence, Amgen argued that respondent was not entitled to a class-wide presumption of reliance based on the fraud-on-the-market theory and therefore could not satisfy the Rule 23(b)(3) predominance requirement. App. 32a.

4. The district court rejected Amgen's arguments and granted respondent's class certification motion. App. 15a. The court held that respondent could invoke the presumption of reliance arising from the fraud-on-the-market theory because, "to trigger" the presumption, respondent "need only establish that an efficient market exists." App. 40a. The court therefore refused to consider whether respondent had established the materiality predicate—*i.e.*, whether the alleged misrepresentations were in fact material. "[T]he inquiries

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[1] The Amgen executive's statement did not, in fact, say that the advisory committee meeting would not discuss Aranesp. Rather, the executive truthfully explained that the studies that prompted the meeting did not involve Aranesp.

Defendants urge the Court to make do not concern the requirements of Rule 23, but instead concern the merits of the case," the court reasoned, holding that they should be deferred until "a later stage in this proceeding." App. 38a, 40a. For the same reasons, the court also refused to consider Amgen's evidence rebutting the applicability of the fraud-on-the-market theory to this case, holding that class certification "is an inappropriate time to consider [Amgen's] contentions." App. 44a.

5. The Ninth Circuit granted Amgen leave to appeal the district court's certification order pursuant to Federal Rule of Civil Procedure 23(f) and affirmed the district court's order. App. 6a, 13a. The court of appeals rejected Amgen's contention that respondent must provide proof of materiality at the class certification stage. While acknowledging that respondent was required "to prove at the class certification stage [1] that the market for Amgen's stock was efficient and [2] that Amgen's supposed misstatements were public," the Ninth Circuit held that respondent did not need to "prove [3] materiality to avail [itself and the class] of the fraud-on-the-market presumption of reliance at the class certification stage." App. 9a, 12a (emphasis omitted). Rather, respondent had only to "allege materiality with sufficient plausibility to withstand a 12(b)(6) motion." App. 12a.

The reason, the Ninth Circuit explained, is that materiality is an "element[] of the merits of a securities fraud claim," whereas the efficient-market and public-statement predicates to the fraud-on-the-market theory are not. App. 8a-9a. As a "merits issue," the court reasoned, materiality should be addressed only "at trial or by summary judgment motion." App. 13a. The court also grounded its distinction of the materiality predi-

cate from the efficient-market and public-statement predicates on its view that, as to materiality, the arguments of respondent and the class "stand or fall together," rendering "the reliance issue common to the class." App. 8a-9a. Because the court of appeals had concluded that materiality need not be proven for class certification, it also approved the district court's refusal to consider Amgen's rebuttal evidence on that issue. App. 12a-13a.

REASONS FOR GRANTING THE PETITION

The Ninth Circuit's decision deepens an irreconcilable, mature circuit split on important questions of class certification law in securities litigation. While the Ninth Circuit acknowledged that a plaintiff bringing a private action under Rule 10b-5 must prove certain predicates to the fraud-on-the-market theory for class certification, the court wrongly held that plaintiffs need not prove an equally important predicate to that theory—the materiality of the alleged misrepresentation. Yet, absent proof of materiality, the fundamental premise of this Court's decision in *Basic* v. *Levinson*, 485 U.S. 224 (1988), is absent. That premise is "that an investor presumptively relies on a misrepresentation *so long as it was reflected in the market price* at the time of his transaction." *Erica P. John Fund* v. *Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011) (emphasis added).

None of the reasons given by the Ninth Circuit for treating the materiality predicate differently from the efficient-market and public-statement predicates has merit. To the contrary, the Ninth Circuit's reasoning contravenes this Court's precedents, including *Basic* and *Erica P. John Fund*. The Ninth Circuit's error—deferring an important step in the fraud-on-the-market analysis until after class certification—will have the

harmful effect of depriving many defendants of any real opportunity to challenge class-wide reliance, given the immense and immediate settlement pressure created by a class certification order in securities litigation.

I. THE NINTH CIRCUIT'S DECISION DEEPENS AN IRRECONCILABLE CONFLICT AMONG THE COURTS OF APPEALS

1. Five circuits have addressed the questions presented by this petition, with those courts dividing into three camps.

The Second and Fifth Circuits hold that a plaintiff must prove materiality for class certification and that defendants may present evidence to rebut the applicability of the fraud-on-the-market theory at the class certification stage. The Second Circuit, in *In re Salomon Analyst Metromedia Litigation*, 544 F.3d 474 (2d Cir. 2008), held that for a plaintiff to obtain class certification based on the fraud-on-the-market theory, it must show that the defendant "publicly made ... a *material* misrepresentation." *Id.* at 481 (emphasis added). The court explained that "[t]he point of *Basic* is that an effect on market price is presumed based on the *materiality* of the information and a well-developed market's ability to readily incorporate that information into the price of securities." *Id.* at 483 (emphasis added; emphasis in original omitted). Because both of these factors—materiality and market efficiency—are predicates to the class-wide presumption of reliance, the Second Circuit ruled that an examination of materiality is necessarily part of the required "definitive assessment" of "factual disputes relevant to each Rule 23 requirement." *Id.* at 484 (emphasis and internal quotation marks omitted). In contrast to the Ninth Circuit's ruling here, the Second Circuit explained: "we hold that

plaintiffs must show that the statement is material (a prima facie showing will not suffice)." *Id.* at 486 n.9.

The Second Circuit also held in *In re Salomon* that once a plaintiff has offered proof as to all the predicates to the fraud-on-the-market theory, a defendant is then "allowed to *rebut* the presumption, prior to class certification, by showing, for example, the absence of a price impact." 544 F.3d at 484 (emphasis added). The court explained: "a successful rebuttal *defeats* certification by defeating the Rule 23(b)(3) predominance requirement." *Id.* at 485. "Hence, the court must permit defendants to present their rebuttal arguments 'before certifying a class[.]'" *Id.* (quoting *In re Initial Public Offerings Sec. Litig.*, 471 F.3d 24, 41 (2d Cir. 2006)).

The Fifth Circuit likewise requires plaintiffs to offer "proof of a *material* misstatement ... in order to trigger the fraud-on-the-market presumption." *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261, 265 (5th Cir. 2007), *abrogated on other grounds by Erica P. John Fund*, 131 S. Ct. 2179 (emphasis added). This principle followed from the court's earlier holding in *Unger* v. *Amedisys Inc.*, 401 F.3d 316, 322 (5th Cir. 2005), that a Rule 10b-5 plaintiff must also prove the efficient-market predicate at the class certification stage. In *Unger*, the Fifth Circuit explained: "When a court considers class certification based on the fraud on the market theory, it must engage in thorough analysis, weigh the relevant factors, require both parties to justify their allegations, and base its ruling on admissible evidence." *Id.* at 325. Like the Second Circuit, the Fifth Circuit also holds that the class certification stage, not summary judgment or trial, is "the proper time for defendants to rebut lead Plaintiffs'

fraud-on-the-market presumption." *Oscar Private Equity*, 487 F.3d at 270.[2]

The Third Circuit has adopted an intermediate approach. That court holds that plaintiffs need not demonstrate materiality as part of an initial showing before class certification. *See In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 631 (3d Cir. 2011). However, as in the Second and Fifth Circuits, defendants in the Third Circuit may rebut the applicability of the fraud-on-the-market theory by disproving the materiality of the alleged misrepresentation. In *In re DVI*, the Third Circuit held that "rebuttal of the presumption of reliance falls within the ambit of issues that, if relevant, should be addressed by district courts at the class certification stage." *Id.* at 638. One way that a defendant can rebut the presumption of reliance is by showing that "the misrepresentations were immaterial." *Id.* at 637. The Third Circuit also explicitly agreed with the Second Circuit's decision in *In re Salomon* that "a defendant's successful rebuttal demonstrating that misleading material statements or corrective disclosures did not affect the market price of the security defeats the presumption of reliance for the entire class, thereby defeating the Rule 23(b) predominance requirement." *Id.* at 638.

In contrast to the Second, Third, and Fifth Circuits, the Seventh Circuit holds that district courts are barred from evaluating materiality at the class certification stage. In *Schleicher* v. *Wendt*, 618 F.3d 679, 685

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[2] The First and Fourth Circuits have also stated that a plaintiff must prove materiality at the class certification stage, albeit in dicta. *See In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 7 n.11 (1st Cir. 2005); *Gariety* v. *Grant Thornton, LLP*, 368 F.3d 356, 364 (4th Cir. 2004).

(7th Cir. 2010), that court held that materiality is exclusively a "merits" question that courts may not even "peek" at for purposes of class certification. A plaintiff accordingly "need not establish that the false statements or misleading omissions are material" at the class certification stage. *Id.* at 687. In reaching this conclusion, the Seventh Circuit disagreed with the First and Second Circuits, labeling their decisions a "misread[ing]" of *Basic*. *Id.*[3]

The Ninth Circuit's decision in this case places it firmly on the Seventh Circuit's side in this preexisting split. The decision explicitly acknowledges and then rejects the position of those "circuits that require a plaintiff to prove materiality at the class certification stage," pointing to decisions of the First, Second, and Fifth Circuits. App. 10a-11a. And, by condoning the district court's refusal to consider Amgen's evidence rebutting materiality, the Ninth Circuit's holding is also in direct conflict with the holdings of the Second, Third, and Fifth Circuits that a defendant may present evidence at the class certification stage rebutting the applicability of the fraud-on-the-market theory. *See* App. 12a-13a. The Ninth Circuit instead expressly aligns itself with the Seventh Circuit, stating that it joins that court in holding that a plaintiff "must plausibly allege—but need not *prove* at this juncture—that the claimed misrepresentations were material." App. 2a (emphasis in original).[4]

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[3] No petition for certiorari was filed seeking review of the judgment in the Seventh Circuit.

[4] The Ninth Circuit also said that it was joining the Third Circuit. *See* App. 2a. But the Ninth Circuit did not acknowledge that the Third Circuit does permit examination of materiality at the

This circuit split is entrenched and mature. Moreover, with the Ninth Circuit having entered the fray, the split now involves courts of appeals for circuits that account for a substantial majority of securities fraud litigation. In 2010 and 2011, 74% and 73% (respectively) of all securities fraud class actions were filed in the Second, Third, Fifth, Seventh, and Ninth Circuits.[5]

2. The circuit split concerns important issues of class certification law in the securities field that only this Court can resolve. This Court endorsed the presumption of reliance based on the fraud-on-the-market theory to "alleviate" the concern that the reliance element of a securities fraud claim could make class-action litigation impossible. *Erica P. John Fund*, 131 S. Ct. at 2185; *see Basic*, 485 U.S. at 242. This Court endorsed only a presumption, however, allowing defendants to rebut it. *See Basic*, 485 U.S. at 248. The issue at the heart of the circuit split here is whether defendants should be forced to defend securities fraud litigation against a class of plaintiffs, based on a rebuttable presumption, in instances where the named plaintiff has yet even to prove all the predicates to the very theory that allows for class certification in the first place, and

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class certification stage, as part of a defendant's rebuttal of the applicability of the fraud-on-the-market theory.

[5] *See* Stanford Law School Securities Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings: 2010 Year in Review* 30 (2011), *available at* http://securities.stanford.edu/clearinghouse_research/2010_YIR/Cornerstone_Research_Filings_2010_YIR.pdf; Stanford Law School Securities Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings: 2011 Year in Review* 32 app. 4 (2012), *available at* http://securities.stanford.edu/clearinghouse_research/2011_YIR/Cornerstone_Research_Filings_2011_YIR.pdf.

where the defendant is given no opportunity for rebuttal prior to certification.

In addition to illogic, there is an important fairness concern. It is commonly recognized that "[a]n order granting certification ... may force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability." Fed. R. Civ. P. 23(f) advisory committee's note, 1998 Amendments. This Court and others have recognized this phenomenon. *See, e.g., Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 476 (1978) ("Certification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense."); *Newton* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 192 (3d Cir. 2001) ("[C]lass certification would place hydraulic pressure on defendants to settle[.]"); Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 99 (2009) ("With vanishingly rare exception, class certification sets the litigation on a path toward resolution by way of settlement, not full-fledged testing of the plaintiffs' case by trial.").

This "*in terrorem* power of certification" is particularly acute in the securities litigation context. *Oscar Private Equity*, 487 F.3d at 267; *see also Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740 (1975) ("[I]n the field of federal securities laws governing disclosure of information even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial[.]"). Only 0.3 percent of all securities fraud class actions ever reach a verdict at trial. *See* Stanford Law School Secu-

rities Class Action Clearinghouse & Cornerstone Research, *2010 Year in Review*, *supra*, at 14.

Until this Court resolves the circuit conflict on the questions presented, class certification frequently will depend on the circuit in which a case is filed. Had this case been filed in the Second or Fifth Circuit, respondent would have been required to establish materiality as a precondition to class certification, and in the Second, Third, or Fifth Circuit, Amgen would have had an opportunity to rebut any such showing. Yet, in the Seventh and Ninth Circuits, as was the case for Amgen here, a class can be certified without any proof of the materiality predicate and notwithstanding the defendant's offer of evidence rebutting materiality.

The practical consequences are substantial. Given the immense settlement pressure generated by class certification orders in securities fraud litigation, defendants in the Seventh and Ninth Circuits will frequently be forced, by practical realities, to settle cases for enormous sums regardless of whether they have a meritorious materiality defense that would rebut application of the fraud-on-the-market theory. The result is that in some circuits, but not others, there may be no realistic opportunity for defendants to litigate a critical underpinning of the fraud-on-the-market theory—materiality. A rule that postpones consideration of materiality until summary judgment or trial effectively means that, in most cases, there will be no examination of materiality—at any stage of litigation.[6]

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[6] The availability of the summary-judgment procedure does not alter this risk calculus. First, materiality is a "mixed question of law and fact" involving "inferences" that "are peculiarly ones for the trier of fact." *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438,

3. There are compelling reasons for this Court to address the questions presented now, in this case. As the Court is aware, the respondent in *Erica P. John Fund* sought to raise effectively the same issues, but the Court could not reach them because the lower court decision in that case concerned only "loss causation," a "familiar and distinct concept" from reliance. 131 S. Ct. at 2187; *see id.* ("Halliburton's theory is that if a misrepresentation does not affect market price, an investor cannot be said to have relied on the misrepresentation[.] We do not accept Halliburton's wishful interpretation of the Court of Appeals' opinion. ... [W]e simply cannot ignore the Court of Appeals' repeated and explicit references to 'loss causation.'"). This Court thus explained in its decision that it was refraining from addressing any questions about *Basic* v. *Levinson* beyond the narrow holding about the "distinct concept" of loss causation. Because "the Court of Appeals erred by requiring [petitioner] to prove loss causation at the certification stage, we need not, and do not, address *any other question* about *Basic*, its presumption, or how and when it may be rebutted." *Id.* (emphasis added); *see also id.* at 2187 n.* (declining to address Halliburton's argument that defendants can raise price impact in rebuttal). The Ninth Circuit's decision here, issued after this Court's ruling in *Erica P. John Fund*, has now cemented the preexisting circuit split on the questions presented in this petition—with the Ninth Circuit ac-

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450 (1976); *see also Basic*, 485 U.S. at 236 (materiality is an "inherently fact-specific finding"). Second, once a class has been certified, the risks associated with litigating such a summary judgment motion to a decision increase exponentially, and constitute a critical part of the settlement pressure recognized by this Court and other authorities.

knowledging the conflict among the courts of appeals and joining the minority position.

This petition squarely presents for this Court's review both the question whether the materiality predicate must be examined at the class certification stage and the question whether it may be rebutted at the same stage. Among Amgen's principal defenses to class certification were its arguments that respondent failed to prove the materiality of the alleged misstatements and that rebuttal evidence disproved materiality. The Ninth Circuit's decision cleanly resolved class certification on the purely legal grounds that respondent did not need to prove materiality for class certification and Amgen was not permitted to present rebuttal evidence on the issue. *See* App. 12a-13a. Unless both of those rulings are correct, the lower courts' orders granting and affirming class certification cannot stand.

This petition also presents this Court with what may be a rare opportunity to resolve the important questions presented. When class certification orders reach the appellate courts for review, it is normally by means of an interlocutory appeal under Rule 23(f). For example, that is true of all of the cases in the circuit split at issue here. *See* App. 6a; *In re DVI*, 639 F.3d at 629 & n.6; *Schleicher*, 618 F.3d at 683; *In re Salomon Analyst Metromedia Litig.*, 544 F.3d at 479-480; *Oscar Private Equity*, 487 F.3d at 263. Given the frequent settlement of large-scale securities class actions after district courts grant class certification motions, and the rarity of plaintiffs continuing to litigate putative class actions after district courts deny class certification, it is rare that contested class certification orders are reviewed in appeals from district court final judgments.

Now that the Second, Third, Fifth, Seventh, and Ninth Circuits have resolved the questions presented for their respective circuits, the likelihood that the issues will be presented again in a discretionary Rule 23(f) appeal is necessarily low. Courts of appeals generally grant permission for a Rule 23(f) appeal only when the district court's class certification order presents an important question of class-action law that is unsettled within the circuit, or the order is both questionable and likely to have a case-ending effect. *Chamberlan* v. *Ford Motor Co.*, 402 F.3d 952, 959 (9th Cir. 2005).[7] In the five circuits that are part of the split, the courts of appeals have settled the law on the questions here presented, making further Rule 23(f) appeals of those issues unlikely. These circuits account for almost three quarters of all securities fraud class action filings. *See supra* p. 13 & n.5. This petition accordingly presents the right opportunity for this Court to resolve a circuit conflict that has ongoing major importance but may not be presented again to this Court.

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[7] *See also, e.g.*, *Sumitomo Copper Litig.* v. *Credit Lyonnais Rouse, Ltd.*, 262 F.3d 134, 139 (2d Cir. 2001) (appeals permitted where "the certification order will effectively terminate the litigation and there has been a substantial showing that the district court's decision is questionable, or ... the certification order implicates a legal question about which there is a compelling need for immediate resolution."); *Newton*, 259 F.3d at 165 (appeals permitted where they would allow the court to address "(1) the possible case-ending effect of an imprudent class certification decision (the decision is likely dispositive of the litigation); (2) an erroneous ruling; or (3) facilitate development of the law on class certification"); *Blair* v. *Equifax Check Servs., Inc.*, 181 F.3d 832, 834-835 (7th Cir. 1999) (appeal permitted if it would "facilitate the development of the law" or the petitioner has "a solid argument in opposition to the district court's decision" and can show that the decision effectively terminates the litigation).

II. THE NINTH CIRCUIT'S DECISION IS WRONG

The petition should be granted for the further reason that the Ninth Circuit fundamentally erred. Logic, fairness, and this Court's analogous precedents require proof of materiality and an opportunity for rebuttal before class certification.

A. A District Court Must Demand Proof Of The Materiality Predicate To The Fraud-On-The-Market Theory Before Class Certification

In private securities fraud cases where a plaintiff seeks to invoke the fraud-on-the-market theory to prove reliance on a class-wide basis, the plaintiff must prove *all* of the theory's predicates for a district court to certify a class. This Court has held that plaintiffs must prove, and district courts must rigorously analyze, the efficient-market and public-statement predicates to the fraud-on-the-market theory:

> It is undisputed that securities fraud plaintiffs must prove certain things in order to invoke *Basic*'s rebuttable presumption of reliance. It is common ground, for example, that plaintiffs must demonstrate that the alleged misrepresentations were publicly known (else how would the market take them into account?), that the stock traded in an efficient market, and that the relevant transaction took place "between the time the misrepresentations were made and the time the truth was revealed."

Erica P. John Fund, 131 S. Ct. at 2185 (quoting *Basic*, 485 U.S. at 248); *see also Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541, 2552 n.6 (2011). The courts of appeals hold the same. *See, e.g., In re DVI*, 639 F.3d at 631, 633; *Schleicher*, 618 F.3d at 682, 688; *Unger*, 401

F.3d at 322. Indeed, the Ninth Circuit so held in this case, ruling that "the district court was correct to require [respondent] to prove at the class certification stage that the market for Amgen stock was efficient and that Amgen's supposed misstatements were public." App. 9a.

The question whether an alleged misstatement is material is just as important to determining the applicability of the fraud-on-the-market theory. Absent materiality, the fundamental premise of *Basic* is not established, because an essential link between the misstatement and the plaintiff is entirely missing. The premise of *Basic* is that a purchaser or seller of a security can be presumed to have *indirectly* relied on a material misstatement through that person's *direct* reliance on the integrity of the market price for the security, which price in turn reflects all material information. This Court explained in *Basic*:

> An investor who buys or sells stock at the price set by the market [presumably] does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public *material* misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.

485 U.S. at 247 (emphasis added); *see also id.* at 244 ("In an open and developed market, the dissemination of *material* misrepresentations or withholding of *material* information typically affects the price of the stock, and purchasers generally rely on the price of the stock as a reflection of its value." (emphasis added; internal quotation marks omitted)).

There is no logical basis for courts analyzing the applicability of the fraud-on-the-market theory at the class certification stage to treat any of the predicates to the theory differently from the others. There is more than one reason why an alleged misrepresentation would not be "reflected in the market price at the time of [a plaintiff's] transaction." *Erica P. John Fund*, 131 S. Ct. at 2186. It may be that the market for the security is not efficient, hence the requirement by courts that a plaintiff demonstrate the efficient-market predicate for class certification. But it may also be that the misstatement itself is not material, in which case the statement cannot be presumed to have affected the security's price. *Basic* and its logic thus require that all predicates to the fraud-on-the-market theory—including the materiality predicate—be examined before class certification to determine whether the named plaintiff has any way to prove the reliance element of a Rule 10b-5 claim on a class-wide basis.

Failing to examine materiality is especially inappropriate and prejudicial in light of more recent studies of the efficient capital markets theory. When this Court decided *Basic*, it relied in part on evidence that "[r]ecent empirical studies" tended to confirm the efficient-market theory. 485 U.S. at 246. Subsequent studies paint a more complex picture. Some studies have shown that the criteria commonly applied in federal courts to determine "efficiency," *see, e.g.*, *Cammer* v. *Bloom*, 711 F. Supp. 1264, 1286-1287 (D.N.J. 1989), do not invariably predict whether new, material information will be incorporated into a security's market

price.[8] Other studies have shown that markets can be efficient in some respects, but not in others—*e.g.*, as to some types of information but not as to other types, as to some sources of information but not as to other sources, and over some periods of time but not others.[9] A rule that requires examination of only the efficient-market and public-statement predicates, and pays no attention to the alleged misstatements themselves, will therefore be inadequate to support a conclusion at class certification that reliance can in fact be proven on a class-wide basis through the fraud-on-the-market theory.

Rather, market efficiency and materiality are both essential and often intertwined when determining whether a presumption of reliance is appropriate. Both must be examined. The misrepresentation at issue must have been material, the market must have been efficient, and the market must have been efficient as to that misrepresentation. That is, a presumption of reliance is appropriate only "so long as [the misrepresenta-

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[8] *See, e.g.*, Erenburg et al., *The Paradox of "Fraud-on-the-Market Theory": Who Relies on the Efficiency of Market Prices?*, 8 J. Empirical Legal Stud. 260, 264, 300 (2011); Macey et al., *Lessons From Financial Economics: Materiality, Reliance, and Extending the Reach of Basic v. Levinson*, 77 Va. L. Rev. 1017, 1025-1026, 1049 (1991).

[9] *See, e.g.*, Macey & Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 Stan. L. Rev. 1059, 1079-1091 (1990); Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance* 2 (2000); Dunbar & Heller, *Fraud on the Market Meets Behavioral Finance*, 31 Del. J. Corp. L. 455, 471 (2006); Fox, *The Myth of the Rational Market* (2009); Brown et al., *Analyst Recommendations, Mutual Fund Herding, and Overreaction in Stock Prices* 33-34 (AFA 2010 Atlanta Meetings Paper 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1363837.

tion] *was reflected in* the market price at the time of [the] transaction." *Erica P. John Fund*, 131 S. Ct. at 2186 (emphasis added). A rule that instead permits a presumption of reliance at class certification without any examination of the materiality of the statement itself is supported by neither "common sense" nor "probability." *Basic*, 485 U.S. at 246.

For the same reasons, the fundamental logic of *Basic* requires that defendants be permitted to rebut application of the fraud-on-the-market theory to the facts of their cases—whether that rebuttal is based on the immateriality of the statements at issue, the inefficiency of the market, or some other pertinent fact. This Court endorsed the presumption of reliance in *Basic* with the express understanding that defendants could rebut it. *See* 485 U.S. at 248. Given the immense settlement pressure created by class certification in securities fraud cases, that right would be effectively meaningless if it could not be exercised until after class certification.

Nor is there any rationale for excluding materiality alone from the issues on which a defendant can seek to rebut a plaintiff's invocation of the fraud-on-the-market theory. This Court made no such distinction in *Basic* in describing the potential rebuttal evidence a defendant might present, holding that "*[a]ny showing* that severs the link between the alleged misrepresentation and ... the price received (or paid) by the plaintiff" is "sufficient to rebut the presumption of reliance." 485 U.S. at 248 (emphasis added). Indeed, this Court specifically discussed facts relevant to materiality, including the very type of showing that Amgen made in this case, as adequate to rebut the presumption of reliance. For example, the Court explained that if "the 'market makers' were privy to the truth" of the alleged misrepresenta-

tions, "the market price would not have been affected by [the] misrepresentations," and "the basis for finding that the fraud had been transmitted through market price would be gone." *Id.* *Basic* itself therefore directs that defendants be permitted to rebut the application of the fraud-on-the-market theory to the facts of a case, including by rebutting a showing of materiality.

B. The Ninth Circuit's Reasons For Refusing To Examine Materiality Before Class Certification Have No Merit

The Ninth Circuit offered two reasons for refusing to examine materiality (or permit any rebuttal evidence on the issue) before class certification, but neither has merit.

1. The court reasoned first that materiality is "an element of the *merits* of [the] securities fraud claim," and therefore should "be reached at trial or by summary judgment motion." App. 8a, 13a. In contrast, the court reasoned, market efficiency and the public nature of the alleged misstatements "are not elements of the merits of a securities fraud claim," and therefore are appropriately examined at the class certification stage. App. 9a. This reasoning is flawed for at least two reasons.

First, it is directly contrary to this Court's decision in *Dukes*, 131 S. Ct. 2541. There, this Court held that district courts must examine all issues relevant to the Rule 23 class certification inquiry, regardless of whether those issues overlap with or are identical to issues that must later be considered at summary judgment or at trial. "A party seeking class certification must affirmatively demonstrate his compliance with" Rule 23 by proving "*in fact*" that the Rule's requirements are satisfied. *Id.* at 2551. "[C]ertification is

proper only if 'the trial court is satisfied, after a rigorous analysis,'" that Rule 23's prerequisites are met. *Id.* (quoting *General Tel. Co. of Sw.* v. *Falcon*, 457 U.S. 147, 161 (1982)). "Frequently, that 'rigorous analysis' will entail some overlap with the merits of the plaintiff's underlying claim," this Court recognized, but "[t]hat cannot be helped." *Id.* Class certification, of necessity, "'generally involves considerations that are enmeshed in the factual and legal issues comprising the plaintiff's cause of action.'" *Id.* at 2551-2552 (quoting *Falcon*, 457 U.S. at 160).

The facts of *Dukes* well illustrate why the Ninth Circuit's reasoning is mistaken. In *Dukes*, this Court fully appreciated that the requisite "proof of commonality necessarily overlaps with respondents' merits contention that Wal-Mart engages in a pattern or practice of discrimination." 131 S. Ct. at 2552 (emphasis omitted). To establish the Rule 23 commonality requirement, plaintiffs had to show that "Wal-Mart 'operated under a general policy of discrimination.'" *Id.* at 2553. And to establish the merits requirement of a "pattern or practice of discrimination," *id.* at 2552 (emphasis omitted), plaintiffs had to show that "discrimination was the company's standard operating procedure," *id.* at 2552 n.7 (internal quotation marks omitted). Notwithstanding this overlap, the Court held that plaintiff had to submit—at the class certification stage—"significant proof" of a "general policy of discrimination." *Id.* at 2553 (internal quotation marks omitted).

Second, the Ninth Circuit's logic does not, in any event, distinguish materiality from the efficient-market and public-statement predicates. In a case in which the plaintiff is proceeding on a fraud-on-the-market theory, all of those predicates are effectively elements of the claim. This is because the plaintiff seeks to establish

both its own claim and those of the class based on a common presumption of indirect reliance arising from the fraud-on-the-market theory.[10] Thus, for the plaintiff to prove both its own claim and the claims of the class members at trial or on summary judgment, the plaintiff must prove not only that the misrepresentation was material, but also that the misrepresentation was public and the market was efficient. *See Dukes*, 131 S. Ct. at 2552 n.6 ("To invoke [the fraud-on-the-market] presumption, the plaintiffs seeking 23(b)(3) certification must prove that their shares were traded on an efficient market, an issue they will surely have to prove *again* at trial in order to make out their case on the merits." (citing *Erica P. John Fund*, 131 S. Ct. at 2185)). Absent proof of all three predicates—materiality, market efficiency, and the public nature of the misstatement—liability could not be established because the plaintiff would not have proven reliance for either itself or the class.

Thus, whether the Ninth Circuit labels these predicates as "elements of the merits of a securities fraud claim" (App. 9a) or something else, all three must be proven again at the merits stage to establish reliance. *Dukes* makes plain that this fact provides no basis for excusing proof at the class certification stage. *See* 131 S. Ct. at 2552 n.6.[11]

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[10] That was the case here, as respondent admitted that it did not rely on, consult, review, or even see any of the misstatements it alleged.

[11] This Court's disposition of the pending certiorari petition in *Comcast Corp.* v. *Behrend*, No. 11-864 (U.S. petition for cert. filed Jan. 11, 2012), should not affect consideration of the petition in this case. That petition seeks summary reversal of a Third Circuit de-

2. The Ninth Circuit's second reason for refusing to examine materiality (or to permit any rebuttal evidence on the issue) before class certification was that the arguments for and against a misstatement's materiality are themselves common to the class, and therefore support, rather than undermine, the basis for class certification. *See* App. 8a-10a. That reasoning again fails to distinguish materiality from the efficient-market and public-statement predicates. The arguments for and against market efficiency also are common across a putative class. Nevertheless, because of the importance of the fraud-on-the-market theory to overcoming an otherwise insuperable bar to class certification in securities fraud cases, *see Basic*, 485 U.S. at 242, this Court and courts of appeals hold that plaintiffs must prove, district courts must rigorously analyze, and defendants may present rebuttal evidence on whether the market is efficient for the security in question. *See supra*, pp. 19-20 (citing cases).

The determination whether the fraud-on-the-market theory applies on the facts of any single case is

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cision because, the petition alleges, the court contravened *Wal-Mart Stores, Inc.* v. *Dukes* by refusing to consider merits issues bearing on class certification. It is an antitrust case, not a fraud-on-the-market securities case. It therefore does not touch upon the questions presented here, which are particular to this Court's jurisprudence regarding the fraud-on-the-market theory, the corresponding presumption of reliance, and the right of rebuttal described in *Basic*. While this Court's holding in *Wal-Mart* is relevant to refute one strand of the Ninth Circuit's reasoning here, reversal of the Third Circuit's decision in *Comcast*, on the authority of *Wal-Mart*, would not resolve the very different securities-law circuit splits at issue here. Indeed, the Ninth Circuit has already fully considered *Wal-Mart* for itself and nevertheless ruled the way it did on the fraud-on-the-market issues presented here.

instrumental to deciding whether a securities fraud plaintiff has any way to prove a case on behalf of a broad class. Rule 23, and this Court's precedents, require that district courts analyze all of the issues pertinent to Rule 23—not some. The Ninth Circuit's selection of materiality for different treatment than the other fraud-on-the-market predicates has no basis in the logic of *Basic*, its progeny, or Rule 23.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Plaintiff-Appellee,

v.

AMGEN INC.; KEVIN W. SHARER; RICHARD D. NANULA; ROGER M. PERLMUTTER; GEORGE W. MORROW,
Defendants-Appellants.

Appeal from the United States District Court
for the Central District of California
Philip S. Gutierrez, District Judge, Presiding

No. 09-56965
D.C. No. 2:07-cv-02536-PSG

Argued and Submitted
October 14, 2011—Pasadena, California

Filed November 8, 2011

Before: Barry G. Silverman and Kim McLane Wardlaw, Circuit Judges, and William K. Sessions III,*
District Judge.

Opinion by Judge Silverman

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* The Honorable William K. Sessions III, United States District Judge for the District of Vermont, sitting by designation.

OPINION

SILVERMAN, Circuit Judge:

To obtain class certification in a 10b-5 securities fraud case, the plaintiff, as required by Federal Rule of Civil Procedure 23(b)(3), must convince the district court that the element of reliance is common to the class. The Supreme Court has held that this can be done in an appropriate case by invoking the "fraud-on-the-market" presumption—the principle that the market price of a security traded in an efficient market reflects all public information and therefore that a buyer of the security is presumed to have relied on the truthfulness of that information in purchasing the security. Were it not for the fraud-on-the-market presumption, a plaintiff seeking class certification would be required to show the impossible—reliance by each individual prospective class member who bought the stock.

What must a plaintiff do to invoke the fraud-on-the-market presumption in aid of class certification? Today we join the Third and Seventh Circuits in holding that the plaintiff must (1) show that the security in question was traded in an efficient market (a fact conceded here), and (2) show that the alleged misrepresentations were public (a fact not contested here). As for the element of materiality, the plaintiff must plausibly allege—but need not *prove* at this juncture—that the claimed misrepresentations were material. Proof of materiality, like all other elements of a 10b-5 claim, is a merits issue that abides the trial or motion for summary judgment. Likewise, rebuttal of the fraud-on-the-market presumption, at least by showing that the alleged misrepresentations were not material, is a matter

for trial or summary judgment, not a matter to be taken up in a class certification motion.

In this case, the plaintiff plausibly alleged that several of the defendants' public statements about Amgen's pharmaceutical products were false and material. Coupled with the concession that Amgen's stock traded in an efficient market, this was sufficient to invoke the fraud-on-the-market presumption of reliance. The district court did not abuse its discretion in certifying the class.

I. Background

Connecticut Retirement Plans and Trust Funds brought this securities fraud action against biotechnology company Amgen Inc. and several of its officers, alleging that, by misstating and failing to disclose safety information about two Amgen products used to treat anemia (a red blood cell deficiency), they violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78t(a), and Rule 10b-5, 17 C.F.R. § 240.10b-5.

The complaint alleges four actionable misstatements. First, Amgen supposedly downplayed the FDA's safety concerns about its products in advance of an FDA meeting with a group of oncologists. Second, Amgen allegedly concealed details about a clinical trial that was canceled over concerns that Amgen's product exacerbated tumor growth in a small number of patients. Third, Amgen purportedly exaggerated the on-label (that is, for FDA-approved uses) safety of its products. And fourth, Amgen allegedly misrepresented its marketing practices, claiming that it promoted its products solely for on-label uses when it in fact promoted significant off-label usage, in violation of federal drug branding statutes.

Those alleged misstatements and omissions, according to the complaint, inflated the price of Amgen's stock when Connecticut Retirement purchased it. Later, corrective disclosures allegedly caused Amgen's stock price to fall, injuring Connecticut Retirement.

II. The District Court's Class Certification Order

Connecticut Retirement moved in the district court to certify the action as a class action under Federal Rule of Civil Procedure 23(b)(3) on behalf of all purchasers of Amgen stock between the date of the alleged misstatements and omissions and the date of the corrective disclosures. Rule 23(b)(3) permits a party to maintain a class action if the Rule 23(a) prerequisites are satisfied and "the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b)(3).

The district court found that the Rule 23(a) prerequisites were satisfied and that common questions predominated. Of the elements of a claim under Section 10(b) and Rule 10b-5, the district court found that the following questions were common to the class: whether Amgen made false statements, whether those statements were material, whether those statements were connected with the sale of securities, whether those statements were intentionally false, and whether those statements caused the class members' losses. The district court further found that although the class members' losses differed depending on when and how much they bought, the losses would be simple to calculate.

The district court also ruled that the remaining element—reliance—was common to the class because the class could avail itself of the fraud-on-the-market presumption of reliance. That doctrine, first approved by the Supreme Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), rests on the efficient capital market hypothesis: The price of a stock traded in an efficient market fully reflects all publicly available information about the company and its business. *See* 485 U.S. at 241-42, 244-45, 246-47. If the stock price did not reflect a piece of publicly available information, the logic goes, then investors would have a strong incentive to buy the stock (if the information were positive) or sell it (if negative); in an efficient market, that activity would drive the stock price up or down until it fully reflected the information. Anyone who buys stock at the prevailing market price is presumed to have relied on that price—and, by extension, each piece of publicly available information it reflects—as a measure of the stock's value, even if the investor never saw that information. *See id.* at 247. Thus, the fraud-on-the-market presumption is a way to prove reliance—a causal link from the defendant's misrepresentation, reflected in the prevailing market price, to each class member's decision to buy the stock. The presumption, however, is rebuttable—for example, by showing that the market was already aware of the truth behind the defendant's supposed falsehoods and thus that those falsehoods did not affect the market price (the so-called "truth-on-the-market" defense), or by showing that a particular plaintiff would have bought the stock without relying on the integrity of the market price. *See Basic*, 485 U.S. at 248-49.

The district court ruled that Connecticut Retirement successfully invoked the fraud-on-the-market

presumption by showing that Amgen's stock traded in an efficient market (which Amgen conceded) and that the alleged misstatements were public (which Amgen did not contest). The district court further held that at the class certification stage, Connecticut Retirement did not need to *prove*—but rather could merely *allege*—that Amgen's supposed falsehoods were material to invoke the fraud-on-the-market presumption. Materiality would, of course, have to be proven at trial.

Moreover, the district court declined to afford Amgen an opportunity to rebut the presumption of reliance at the class certification stage, holding again that rebuttal of the presumption was a trial issue. Amgen's proposed rebuttal consisted of evidence purportedly showing that the truth behind each of the supposed misstatements had already entered the market by the time the misstatements were made. Amgen argued that the misstatements therefore could not have affected Amgen's stock price, or, by extension, anyone relying on the integrity of that stock price.

Having found that the Rule 23(a) prerequisites were satisfied and that common questions predominated, the district court certified the action as a class action under Rule 23(b)(3).

III. Amgen's Interlocutory Appeal

We granted Amgen's Rule 23(f) request for permission to appeal the district court's class certification order. *See Chamberlan v. Ford Motor Co.*, 402 F.3d 952, 959 (9th Cir. 2005). We have jurisdiction under 28 U.S.C. § 1292(e).

IV. Analysis

A. Connecticut Retirement's Motion to Vacate Grant of Permission to Appeal

At the outset, Connecticut Retirement moves to vacate our grant of permission to appeal the certification order, arguing that the central issue in this appeal has been settled by three cases decided since the district court certified the class: *United Steel, Paper & Forestry, Rubber, Manufacturing Energy, Allied Industrial & Service Workers International Union v. ConocoPhillips Co.*, 593 F.3d 802 (9th Cir. 2010), *Dukes v. Wal-Mart Stores, Inc.*, 603 F.3d 571 (9th Cir. 2010) (en banc), *rev'd*, 131 S. Ct. 2541 (2011), and *Miller v. Thane International, Inc.*, 615 F.3d 1095 (9th Cir. 2010). But neither *United Steel Workers* nor *Dukes* was a securities fraud case, and thus neither had occasion to decide whether a securities fraud plaintiff must prove materiality to avail herself of the fraud-on-the-market presumption of reliance. *See United Steel*, 593 F.3d at 804 (state law wage and hour claim); *Dukes*, 131 S. Ct. at 2547 (sex discrimination claim). And *Miller* had no occasion to decide the question either, because that case was brought under a securities fraud statute that—unlike Section 10(b) here—does not require the plaintiff to show reliance. *See Miller*, 615 F.3d at 1102 n.2. Accordingly, because the question remains unsettled, we deny Connecticut Retirement's motion.

B. Elements That Must Be Proved at the Class Certification Stage to Invoke the Fraud-on-the-Market Presumption of Reliance

We review a district court's class certification order for abuse of discretion, and any error of law on which a certification order rests is deemed a per se abuse of discretion. *See United Steel*, 593 F.3d at 807;

Yokoyama v. Midland Nat'l Life Ins. Co., 594 F.3d 1087, 1090-91 (9th Cir. 2010).

As the party seeking class certification, Connecticut Retirement "bears the burden of demonstrating that the requirements of Rules 23(a) and (b) are met." *See United Steel*, 593 F.3d at 807. And the district court facing a class certification motion is required to conduct "a rigorous analysis" to ensure that the Rule 23 requirements are satisfied. *Gen. Tel. Co. of Sw. v. Falcon*, 457 U.S. 147, 161 (1982).

Amgen argues that Connecticut Retirement failed to carry that burden because it did not *prove* that Amgen's supposedly false statements were material. If those misrepresentations were *im*material, Amgen contends, they by definition would not affect Amgen's stock price in an efficient market, and thus no buyer could claim to have been misled by an artificially inflated stock price. Thus, Amgen concludes, each individual plaintiff would be left to prove reliance at trial individually—making a class proceeding unwieldy.

The problem with that argument is that, because materiality is an element of the *merits* of their securities fraud claim, the plaintiffs cannot both fail to prove materiality yet still have a viable claim for which they would need to prove reliance individually. *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341 (2005). If the misrepresentations turn out to be material, then the fraud-on-the-market presumption makes the reliance issue common to the class, and class treatment is appropriate. But if the misrepresentations turn out to be immaterial, then *every* plaintiff's claim fails on the merits (materiality being a standalone merits element), and there would be no need for a trial on each plaintiff's individual reliance. Either way, the plaintiffs' claims

stand or fall together—the critical question in the Rule 23 inquiry. As the Supreme Court said in *Dukes*,

> "[w]hat matters to class certification ... is not the raising of common 'questions'—even in droves—but, rather the capacity of a classwide proceeding to generate common *answers* apt to drive the resolution of the litigation. Dissimilarities within the proposed class are what have the potential to impede the generation of common answers."

131 S. Ct. at 2551 (quoting Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 132 (2009)).

By contrast, the elements of the fraud-on-the-market presumption—whether the securities market was efficient and whether the defendant's purported falsehoods were public—are not elements of the merits of a securities fraud claim. *See Dura Pharm.*, 544 U.S. at 341-42. Thus, if the plaintiffs failed to prove those elements, they could not use the fraud-on-the-market presumption, but their claims would not be dead on arrival; they could seek to prove reliance individually. That scenario, however, would be inappropriate for a class proceeding. Accordingly, the district court was correct to require Connecticut Retirement to prove at the class certification stage that the market for Amgen's stock was efficient and that Amgen's supposed misstatements were public. (Because those elements were uncontested, we need not decide the applicable standard of proof for proving those elements at the class certification stage.)

The Seventh Circuit, recently faced with this same issue, held that proving materiality is not a precondi-

tion to invoking the fraud-on-the-market presumption at the class certification stage:

> Defendants say that, before certifying a class, a court must determine whether false statements materially affected the price. But whether statements were false, or whether the effects were large enough to be called material, are questions on the merits. Although we concluded in [a prior case] that a court may take a peek at the merits before certifying a class, [we] insisted that this peek be limited to those aspects of the merits that affect the decisions essential under Rule 23. If something about "the merits" also shows that individual questions predominate over common ones, then certification may be inappropriate. Falsehood and materiality affect investors alike, however. It is possible to certify a class under Rule 23(b)(3) even though all statements turn out to have only trivial effects on stock prices. Certification is appropriate, but the class will lose on the merits.

Schleicher v. Wendt, 618 F.3d 679, 685 (7th Cir. 2010). The Third Circuit agrees. *See In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 631 (3d Cir. 2011) ("To invoke the fraud-on-the-market presumption of reliance, plaintiffs must show they traded shares in an efficient market, and the misrepresentation at issue became public.") (citations omitted).

The three circuits that require a plaintiff to prove materiality at the class certification stage do so on the apparent rationale that a footnote in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), compels it. *See id.* at 248 n.27 ("The Court of Appeals held that in order to invoke

the presumption, a plaintiff must allege and prove ... that the misrepresentations were material ... ."); *see also In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 481 (2d Cir. 2008) ("The *Basic* Court thereby set forth a test of general applicability that where a defendant has (1) publicly made (2) a material misrepresentation (3) about stock traded on an impersonal, well-developed (i.e., efficient) market, investors' reliance on those misrepresentations may be presumed.") (citing *Basic*, 485 U.S. at 248 n.27); *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 264 (5th Cir. 2007) ("The Supreme Court in *Basic* adopted this presumption of reliance .... Reliance is presumed if the plaintiffs can show that '(1) the defendant made public material misrepresentations ....' ") (citation omitted), *abrogated on other grounds by Erica P. John Fund*, 131 S. Ct. at 2183, 2186; *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 8 n.11 (1st Cir. 2005) (noting in a dictum that to invoke fraud-on-the-market presumption at class certification stage, plaintiff must prove materiality) (quoting *Basic*, 485 U.S. at 248 n.27).

But as the Seventh Circuit pointed out, those circuits misread the *Basic* footnote: "All note 27 [in *Basic*] does ... is state that the court of appeals deemed materiality essential; the Justices did not adopt it as a precondition to class certification." *See Schleicher*, 618 F.3d at 687; *see also Basic*, 485 U.S. at 248 n.27. That reading of *Basic* also enjoys support from the Supreme Court's more recent formulations of the presumption in *Erica P. John Fund* and *Dukes*, which require the plaintiff to show that the stock was traded in an efficient market but do not mention materiality as a requirement. *See Erica P. John Fund v. Halliburton*, 131 S. Ct. 2179, 2185 (2011); *Dukes*, 131 S. Ct. at 2552 n.6.

Moreover, two Ninth Circuit cases have mentioned materiality as an element of the presumption, but neither squarely held that a plaintiff must prove materiality at the class certification stage. *See Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999) (noting that "the presumption of reliance is available only when a plaintiff alleges that a defendant made material misrepresentations or omissions concerning a security that is actively traded in an 'efficient market,'" but holding that presumption did not apply because market was not efficient); *Blackie v. Barrack*, 524 F.2d 891, 900-01 & n.17, 905-08 (9th Cir. 1975) (holding, in pre-*Basic* case, that complaint's allegation of materiality sufficed to trigger presumption).

In sum, because proof of materiality is not necessary to ensure that the question of reliance is common among all prospective class members' securities fraud claims, we hold that plaintiffs need not *prove* materiality to avail themselves of the fraud-on-the-market presumption of reliance at the class certification stage. They need only allege materiality with sufficient plausibility to withstand a 12(b)(6) motion. *See Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949-50 (2009).

C. Opportunity to Rebut the Presumption at the Class Certification Stage

Amgen also argues that the district court erred by not affording it an opportunity to rebut the fraud-on-the-market presumption at the class certification stage. Specifically, Amgen sought to introduce evidence that FDA announcements and analyst reports about Amgen's business publicized the truth about the safety issues looming over Amgen's drugs, and thus that Amgen's alleged misrepresentations could not have affected the stock price—the so-called "truth-on-the-

market" defense. *See, e.g.*, *Basic*, 485 U.S. at 248-49 ("[I]f, despite [defendants'] allegedly fraudulent attempt to manipulate market price, [the truth] credibly entered the market and dissipated the effects of the misstatements, those who traded ... after the corrective statements would have no direct or indirect connection with the fraud.").

But as the Supreme Court and Ninth Circuit have explained, the truth-on-the-market defense is a method of refuting an alleged misrepresentation's *materiality*. *See, e.g.*, *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097-98 (1991); *Provenz v. Miller*, 102 F.3d 1478, 1492 (9th Cir. 1996). As explained above, a plaintiff need not prove materiality at the class certification stage to invoke the presumption; materiality is a merits issue to be reached at trial or by summary judgment motion if the facts are uncontested. The only elements a plaintiff must prove at the class certification stage are whether the market for the stock was efficient and whether the alleged misrepresentations were public—issues that Amgen does not contest here.

Thus, the district court correctly refused to consider Amgen's truth-on-the-market defense at the class certification stage.

AFFIRMED.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Plaintiff,

v.

AMGEN INC.,
Defendant.

No. CV 07-2536 PSG (PLAx)
August 12, 2009

The Honorable Philip S. Gutierrez,
United States District Judge

CIVIL MINUTES—GENERAL

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* * *

Proceedings: (In Chambers) Order Granting Plaintiff's Motion for Class Certification

Pending before the Court is Plaintiff's Motion for Class Certification. The Court heard oral argument on this matter on July 13, 2009. After considering the submissions and arguments of counsel, the Court GRANTS Plaintiff's Motion for Class Certification.

I. Background

This securities fraud action alleges claims against Amgen, Inc. ("Amgen") and certain of its directors and

officers (collectively, "Defendants") under section 10 and 20(a) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder.[1] The case is brought on behalf of a class of purchasers of the publicly traded securities who bought their shares between April 22, 2004 and May 10, 2007, inclusive (the "Class Period").

Put simply, Lead Plaintiff Connecticut Retirement Plans and Trust Funds ("Plaintiff") alleges that Defendants made a series of materially false and misleading statements and omissions during the Class Period which artificially inflated the value of Amgen's stock. Plaintiff further alleges that later "partial corrective disclosures" caused the stock price to decline, causing it and the Class injury.

More specifically, this case concerns alleged misrepresentations and omissions relating to two of Amgen's better known products: Epogen® (epoetin alfa) ("Epogen") and Aranesp® (darbepoetin alfa) ("Aranesp"). In 1989, the Food and Drug Administration ("FDA") approved Epogen for the treatment of anemia associated with chronic renal failure, including end stage renal disease patients and patients on dialysis. *CAC* ¶ 37. Later, the FDA approved Epogen for persons who develop anemia as a consequence of chemotherapy for cancer, treatment of HIV infections with the pharmaceutical zidovudine, chronic kidney disease in pre-dialysis patients, and anemic patients scheduled to undergo elective, non-cardiac, non-vascular surgery. *Id.* at ¶ 38. The FDA also approved Aranesp for cer-

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[1] A more detailed overview of the factual background of this case is discussed in the Court's February 1, 2008 Order Granting in Part and Denying in Part Defendants' Motion to Dismiss, familiarity with which is assumed. *See* Dkt. # 137.

tain purposes. For example, in 2001, Amgen secured FDA approval to market Aranesp for the treatment of anemia associated with chronic renal failure, including patients on dialysis and those not on dialysis. *Id.* at ¶ 42. Then, in 2002, the FDA approved Aranesp for the treatment of anemia associated with cancer chemotherapy. *Id.*

According to Plaintiff, the first actionable statement made by Defendants occurred during an earnings conference call on April 22, 2004. That day, defendant George Morrow ("Morrow")[2] discussed an upcoming meeting the FDA had convened with a group of leading experts in the field of oncology known as the Oncology Drug Advisory Committee ("ODAC"). *Id.* at ¶ 58. The purpose of this meeting was to look into the safety of Aranesp and other Erythopoiesis Stimulating Agents ("ESAs").[3] *Id.* When asked about the upcoming meeting, Morrow allegedly "downplayed the significance of the meeting and the safety concerns of the FDA," telling analysts that Amgen "had decided to participate in that meeting 'cause the focus was not on Aranesp ... [and] there is no signal associated with Aranesp. We've had two perspective randomized placebo controlled trials. And the safety for Aranesp has been comparable to placebo." *Id.* at ¶ 59. Plaintiff contends, however, that these statements were both actionable misstatements and omissions because the ODAC meeting had in fact been convened to assess the safety of Epogen and Aranesp.

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[2] Morrow was, at all relevant times, Amgen's Executive Vice President of Global Commercial Operations. *Id.* at ¶ 19.

[3] Both Epogen and Aranesp are ESAs.

Plaintiff also claims that Defendants knowingly concealed material information concerning a clinical trial that tested whether high doses of Aranesp could aid in shrinking tumors of patients with head and neck cancer receiving radiation therapy. *Id.* at ¶ 64. Known as the DAHANCA 10 trial, DAHANCA investigators temporarily halted the study in October of 2006 "due to information about potential unexpected negative effects related to immunohistochemical estimation of the so-called EPO receptor." *Id.* Then, on December 1, 2006, DAHANCA investigators terminated the study entirely. *Id.* at ¶ 65. According to the DAHANCA Interim Analysis, "there is a small but significant poor outcome in the patients treated with Aranesp" in that the tumor growth was worse for patients who took Aranesp than for those who did not. *Id.* However, despite knowing in mid-October 2006 that DAHANCA 10 had been temporarily halted, and knowing by December 2006 that the study had been terminated early, Amgen allegedly never fully informed investors of these developments. *Id.* at ¶ 4. In fact at least according to Plaintiff, investors did not become informed of these results until February 16, 2007, at which time a newsletter called *The Cancer Letter* reported that the DAHANCA 10 trial had been halted in October 2006 because it showed "significantly inferior therapeutic outcome from adding Aranesp to radiation treatment of patients with head and neck cancer." *Id.* at ¶ 66.

In addition to the foregoing, Plaintiff alleges more generally that throughout the Class Period, Defendants repeatedly touted the on-label safety of Epogen and Aranesp, despite knowing that there were serious concerns regarding their safety. For instance, on March 9, 2007, Amgen issued a statement in which it stated that both drugs have "favorable risk/benefit profiles." *Id.* at

¶ 146. Weeks later, during a conference call with Wall Street Analysts, defendant Kevin Sharer ("Sharer")[4] stated: "The overwhelming conclusion that—that I reach and others have reached in looking at all that data is that on label our drugs are certainly safe." *Id.* at ¶ 147. In Plaintiff's view, these statements improperly downplayed negative clinical trials that demonstrated exactly how unsafe Epogen and Aranesp really were.

Allegedly, due to Defendants' systematic misrepresentations and omissions, investors did not become fully aware of the safety risks of these drugs until May 10, 2007, the day the Class Period ends. It was only then that the corrective disclosures leading to and made at the 2007 ODAC Meeting fully disclosed the falsity and misleading nature of Defendants' prior representations. In relevant part, these disclosures included the following: the already discussed newsletter published in *The Cancer Letter* on February 16, 2007; a February 28, 2007 Amgen announcement that the Securities and Exchange Commission ("SEC") was investigating it with regard to the DAHANCA 10 trial; a March 9, 2007 FDA announcement that the FDA would mandate a black box warning for ESAs, including Aranesp and Epogen; and the May 10, 2007 ODAC vote to place greater restrictions on the use of ESAs. *See CAC* ¶¶ 202-07.

Lastly, Plaintiff alleges that Amgen's statements concerning its sales practices and market growth potential constituted a fraud on investors for another rea-

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[4] Sharer was, at all relevant times, Amgen's Chief Executive Officer and Chairman of the Board of Directors. *Id.* at ¶ 14.

son: they promoted Aranesp and Epogen for unapproved uses and increased per-patient dosages through improper and unlawful means. More specifically, Plaintiff claims that at the same time the FDA was questioning whether ESAs were safe for approved indications and populations, Amgen developed a sophisticated and multifaceted scheme to improperly push the ESAs for unapproved indications and populations, even though Amgen publicly stated that it "only promotes the use of Epogen and Aranesp consistent with the FDA label." *CAC* ¶¶ 81, 84, 103.

Presently, Plaintiff has filed a motion for class certification, to which Defendants have filed an opposition. Additionally, Defendants have filed evidentiary objections and a request to strike, to which Plaintiff has filed a response.

II. Legal Standard

A court may certify a class if a plaintiff has met all the prerequisites of Federal Rule of Civil Procedure 23(a) and at least one of the requirements of Rule 23(b). *See* Fed. R. Civ. P. 23; *Valentino v. Carter-Wallace, Inc.*, 97 F.3d 1227, 1234 (9th Cir. 1996). The burden lies with the plaintiff to establish that these requirements have been met. *Zinser v. Accufix Res. Inst., Inc.*, 253 F.3d 1180, 1186 (9th Cir. 2001).

Under Rule 23(a), a plaintiff must demonstrate that: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the class representatives are typical of the claims or defenses of the class; and (4) the class representatives will fairly and adequately protect the interests of all members of the class. Fed. R. Civ. P. 23(a). If all four

prerequisites of Rule 23(a) are satisfied, a plaintiff also must establish that one or more of the grounds for maintaining the suit under Rule 23(b) are met, including: (1) that there is a risk of substantial prejudice from separate actions; (2) declaratory or injunctive relief benefiting the class as a whole would be appropriate; or (3) common questions of law or fact predominate, and the class action is superior to other available methods of adjudication. Fed. R. Civ. P. 23(b).

In determining whether to certify a class action, a court may not conditionally certify an improper class on the basis of a speculative possibility that it may later meet the requirements of Rule 23. *In re Hotel Tel. Charges*, 500 F.2d 86, 90 (9th Cir. 1974). "However, neither the possibility that a plaintiff will be unable to prove his allegations, nor the possibility that the later course of the suit might unforeseeably prove the original decision to certify the class wrong, is a basis for declining to certify a class which apparently satisfies the Rule." *Blackie v. Barrack*, 524 F.2d 891, 901 (9th Cir. 1975). Put otherwise, in conducting a class certification analysis, courts are not to ask whether the plaintiffs will prevail on the merits, but, rather, they are to ask whether the plaintiffs have met the requirements of Rule 23. *See Staton v. Boeing Co.*, 327 F.3d 938, 954 (9th Cir. 2003) ("Although some inquiry into the substance of a case may be necessary to ascertain satisfaction of the commonality and typicality requirements of Rule 23(a), it is improper to advance a decision on the merits to the class certification stage."); *see also Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 178, 94 S. Ct. 2140, 40 L. Ed. 2d 732 (1974).

In making this determination, a court is bound take the substantive allegations of the complaint as true. *Blackie*, 524 F.2d at 901 n.17; *see also In re Petroleum*

Prods. Antitrust Litig., 691 F.2d 1335, 1342 (9th Cir. 1982). Nevertheless, "[w]hile the court may not put the plaintiff to preliminary proof of his claim, it does require sufficient information to form a reasonable judgment." *Blackie*, 524 F.2d at 901 n.17. Moreover, a court must be mindful that to safeguard due process interests and the judicial process, it must conduct as "rigorous" an analysis as is necessary to determine whether class certification is appropriate. *See Chamberlan v. Ford Motor Co.*, 402 F.3d 952, 961 (9th Cir. 2005); *see also Gen. Tel. Co. of the Sw. v. Falcon*, 457 U.S. 147, 161, 102 S. Ct. 2364, 72 L. Ed. 2d 740 (1982).

III. Plaintiff's Motion for Class Certification

According to Plaintiff, not only can it satisfy the four "prerequisites" of Rule 23(a), it can also establish that "the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. *See* Fed. R. Civ. P. 23(b)(3). In opposition to this motion, Defendants make three arguments. First, they argue that Plaintiff cannot satisfy the adequacy requirement found at Rule 23(a)(4).[5] Second, it is their position that individual questions of fact predominate over common questions of fact and, therefore, Plaintiff cannot satisfy Rule 23(b)(3). Lastly, they contend that Plaintiff has not adequately established the Class Period.

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[5] Defendants do not argue that Plaintiff is unable to establish the other three "prerequisites" of Rule 23(a).

A Rule 23(a) Analysis

The Court begins by analyzing whether Plaintiff has satisfied the four "prerequisites" of Rule 23(a). For a named plaintiff to obtain class certification, a court must find:

> (1) the class is so numerous that joinder of all members is impracticable;
>
> (2) there are questions of law or fact common to the class;
>
> (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and
>
> (4) the representative parties will fairly and adequately protect the interests of the class.

Fed. R. Civ. P. 23(a). Each of these requirements is evaluated in turn.

1. Numerosity

A proposed class meets Rule 23(a)'s numerosity requirement when "the class is so numerous that joinder of all members is impracticable." Fed. R. Civ. P. 23(a)(1). No exact numerical cut-off is required; rather, the specific facts of each case must be considered. *Gen. Tel. Co. of Nw., Inc. v. E.E.O. C.*, 446 U.S. 318, 330, 100 S. Ct. 1698, 64 L. Ed. 2d 319 (1980).

Here, it is undisputed that the class is sufficiently numerous. Not only has Plaintiff alleged that the class consists of "thousands of members," *CAC* ¶ 194, Plaintiff has in fact identified over 1,000 institutional investors that held Amgen shares through[ou]t the proposed class period. *See McDonald Decl.* Ex. 7, at ¶ IV.7. Plaintiff has also established that over 1 billion shares

were outstanding during the proposed Class Period. *Id.* at ¶ IV.5. Thus, it can reasonably be inferred that thousands upon thousands of class members exist.

Also, the parties do not dispute that joinder of thousands of potential plaintiffs would be impracticable and infeasible. In fact, it would most likely be both, particularly in light of other factors, such as the size of individual claims and the geographical dispersion of potential class members. *See In re Unioil Securities Litigation*, 107 F.R.D. 615, 618 (C.D. Cal. 1985) (drawing a similar conclusion when presented with similar facts). Accordingly, the Court finds that Rule 23(a)(1) is satisfied.

2. Commonality

Rule 23(a)(2) requires that class members' claims contain "questions of law and fact common to the class." Fed. R. Civ. P. 23(a)(2). In general, a few factual variations among the class grievances will not defeat commonality so long as class members' claims arise from "shared legal issues" or "a common core of salient facts." *Staton*, 327 F.3d at 953.

Again, it is undisputed that this requirement is met. The legal claims at hand all involve the same basic legal claims: securities frauds. And these legal claims are based on the same nucleus of operative facts: the alleged misrepresentations and omissions relating to the events and clinical trials involving the safety of Amgen's ESAs. *See Schaefer v. Overland Express Family of Funds*, 169 F.R.D. 124, 128 (S.D. Cal. 1996) (finding Rule 23(a)(2) was met in a securities fraud case when the legal claims arose from common misrepresentations). In light of the foregoing, the Court finds that Rule 23(a)(2) is satisfied.

3. Typicality

"The purpose of the typicality requirement is to assure that the interest of the named representative aligns with the interests of the class." *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 508 (9th Cir. 1992) (citation omitted). "'Typicality refers to the nature of the claim or defense of the class representative, and not to the specific facts from which it arose or the relief sought.'" *Id.* (citation omitted). In determining whether the plaintiff has satisfied this requirement, courts look to see "whether other members have the same or similar injury, whether the action is based on conduct which is not unique to the named plaintiffs, and whether other class members have been injured by the same course of conduct." *Id.*

Here, not only are Plaintiff's claims typical to those of other class members, they are in fact substantially identical. Like other class members, Plaintiff bought Amgen stock and sold it for investment purposes. These investment choices were dictated by representations made by Defendants that affected the market at large. Thus, resolving Plaintiff's claims and other class members' claims will require analysis of the same evidence. Additionally, there is nothing in the record that indicates that Plaintiff has a unique background or factual situation that would require it to prepare to meet defenses that are atypical of the defenses which may be raised against other members of the proposed class. *See Hanon*, 976 F.2d at 508 (finding that a named plaintiff failed to satisfy the typicality requirement because it was predictable that a major focus of the litigation would have been on a defense unique to him). In light of the foregoing, the Court finds that Rule 23(a)(3) is satisfied.

4. Adequacy

Rule 23(a)(4) permits the certification of a class action only if "the representative parties will fairly and adequately protect the interests of the class." Fed. R. Civ. P. 23(a)(4). To determine whether the representation meets this standard, courts ask two questions: "(1) Do the representative plaintiffs and their counsel have any conflicts of interest with other class members, and (2) will the representative plaintiffs and their counsel prosecute the action vigorously on behalf of the class?" *Staton*, 327 F.3d at 957 (citing *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1020 (9th Cir. 1998).

Defendants make two arguments as to why Plaintiff cannot satisfy this requirement. First, they contend that because a so-called "equity conflict" exists in this case, Plaintiff is an inadequate representative to certain members in the Class.[6] Second, they argue that since this case involves "partial curative disclosures," the Court should be "considerably more wary" of certifying the class than it would be in a full disclosure case. Each of these arguments is evaluated in turn.[7]

According to Defendants, Plaintiff does not adequately represent the class because there is a conflict between those individuals, like Plaintiff, that purchased

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[6] Other courts that have addressed this or a similar argument refer to this alleged conflict of interest as an "equity conflict." *See In re Tyco Intern., Ltd.*, 236 F.R.D. 62, 68-70 (D.N.H. 2006); *In re Dynegy, Inc. Sec. Litig.*, 226 F.R.D. 263, 277 (S.D. Tex. 2005); *In re HealthSouth Corp. Sec. Litig.*, 213 F.R.D. 447, 462 (N.D. Ala. 2003); *In re Seagate Tech. II Sec. Litig.*, 843 F. Supp. 1341, 1362-64 (N.D. Cal. 1994). For sake of uniformity, this Court follows suit.

[7] Defendants do not argue that Plaintiff is represented by inadequate counsel.

stock during the Class Period and who have retained ownership of that stock (so-called "equity holders") and those class members who purchased and sold their shares during the Class Period (so-called "non-equity holders"). Defendants reason that Plaintiff's interests are antagonistic to those of non-equity holders because Plaintiff, as an equity holder, stands to lose more as a shareholder than it will gain as a class member if Amgen is required to pay damages to the Class.[8] Thus, Defendants argue, Plaintiff has an interest in minimizing the overall liability of the company whereas the non-equity holders, on the other hand, would like to maximize the liability of the company, as doing so will increase their award of damages.

In support of their contention that this equity conflict should prevent certification, Defendants exclusively rely on a case from the Northern District of California, *Seagate II*. *See* 843 F. Supp. 1341. The *Seagate II* court found that "a conflict over price inflation was at the heart of the suit," (emphasis omitted) and that conflicts over the degree of price inflation, as might arise between purchasers with different trading histories or between purchasers who ultimately sold and those who did not, "are not only serious, but ... are pervasive enough to threaten to preclude satisfaction of the adequacy of representation element of FRCP 23." *Id.* at 1358-59. Thus, the court surmised, since an equity holder "may well seek to defeat the other class members' recoveries," his interests are undoubtedly

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[8] In theory, this is because any such payment will result in a corresponding reduction in the company's stock price. *See In re Tyco Intern.*, 236 F.R.D. at 68 (explaining the underlying assumptions of the equity conflict argument).

antagonistic to those of the other class members, thus making him an inadequate representative. *Id.* at 1364.

Over the years, a few courts have embraced *Seagate II* and its reasoning. *See, e.g., O'Neil v. Appel*, 165 F.R.D. 479, 494 (W.D. Mich. 1996). In the main, though, courts[] have rejected *Seagate II*, albeit for a variety of reasons.[9] Some courts, for instance have noted that equity conflicts are present in almost every large, complex securities case and that deeming those conflicts to be an appropriate basis for the denial of class certification would be inconsistent with the Court of Appeals' strongly favorable view of the class action device in securities cases generally. *See In re Honeywell*, 211 F.R.D. at 261. Other courts have, to put it simply, found *Seagate II*'s reasoning to be unpersuasive. As one court aptly explained:

> [The Seagate II view] ... overstates the importance of price inflation. The chief role of price inflation remains its function in determining each plaintiff's damages. The common questions with respect to whether misleading statements or omissions were made, whether such statements were material, and whether they were made with scienter, bind class mem-

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[9] *See, e.g., In re Tyco Intern.*, 236 F.R.D. at 68-70; *In re Schering-Plough Corp. Sec. Litig.*, 2003 U.S. Dist. LEXIS 26297, at *24 (D.N.J. Oct. 9, 2003); *In re Honeywell Int'l, Inc. Sec. Litig.*, 211 F.R.D. 255, 261-62 (D.N.J. 2002) (noting that *Seagate II*'s reasoning has been rejected by an overwhelming majority of courts); *Welling v. Alexy*, 155 F.R.D. 654, 6643 (N.D. Cal. 1994); *Ziemack v. Centel Corp.*, 164 F.R.D. 477, 479 (N.D. Ill. 1995); *In re Mut. Sav. Bank. Sec. Litig.*, 166 F.R.D. 377, 384 (E.D. Mich. 1996) (citing other examples).

> bers with more force than the varying questions related to price inflation drive them apart.

In re Gaming Lottery Sec. Litig., 58 F. Supp. 2d 62, 69-70 (S.D.N.Y. 1999). In a similar vein, lower courts have observed that *Seagate II* is in no small degree of tension with a prominent Ninth Circuit decision in this area of law: *Blackie*, 524 F.2d at 909. *See, e.g., In re Regal Commc'ns Corp. Secs.*, 1995 WL 550454, at *8 (E.D. Pa. 1995). In *Blackie*, the Ninth Circuit observed that, historically speaking, courts have consistently declined "to consider conflicts, particularly as they regard damages, sufficient to defeat class action status at the outset unless the conflict is apparent, imminent, and on an issue at the very heart of the suit." *Blackie*, 524 F.2d at 909. Thus, in ruling as it did, *Seagate II* placed itself in no small degree of tension with a long line of authority that instructs lower courts to avoid handling damages issues at the class certification stage. *See id.*; *see also In re Safeguard Scientifics*, 216 F.R.D. 577, 581 (E.D. Pa. 2003) ("[W]e leave the issue of price inflation to the determination of damages and can address any potential buyer-seller conflicts with the use of subclasses."); *In re Gaming Lottery*, 58 F. Supp. 2d at 69-70 (observing that *Seagate II* is in tension with *Blackie*).

This Court agrees with those courts that have held that an equity conflict does not represent a valid reason for refusing to certify a class. *See, e.g., Blackie*, 524 F.2d at 908-10. The record shows that the antagonism that supposedly exists between equity holders and non-equity holders is not "at the very heart of the suit." *Id.* at 909. Rather, it is "peripheral" to the Class' "overriding common interest in establishing the existence and materiality of misrepresentations." *Id.* It bears repeating that, at its core, this case concerns misrepresentations and omissions made to the public at large.

Other issues, such as the distribution of monetary relief, while undoubtedly important, are nevertheless subordinate to the main issue in this case—whether Defendants are liable under the securities laws. Thus, while class members may have competing interests in distributing the monetary relief, such interests are ultimately ancillary to their unified interest in establishing liability.

The Court also finds that the presence of partial corrective disclosures does not render Plaintiff to be an inadequate class representative. Again, citing to *Seagate II*, Defendants appear to posit that as a result of partial corrective disclosures, there will be a difference in damages among class members. However, besides the fact that, as discussed above, now is an inappropriate time to delve into an inquiry regarding damages, *see Blackie*, 524 F.2d at 909, Defendants appear to miss a critical point of Plaintiff's claims. While Plaintiff alleges that several partial corrective disclosures occurred throughout the Class Period, Plaintiff is taking the position that it was not until the end of the Class Period that the market became *fully* aware of Defendants' misrepresentations and omissions. Put otherwise, since the partial disclosures of fraud did not fully reveal the truth, all class members were misled during the Class Period, albeit at differing degrees. Importantly, what is significant to the Court is not the degree to which Plaintiff was misled but whether it and the other class members were in fact misled. Consequently, the Court finds that any differences in the extent to which Plaintiff and other class members were misled is insufficient to preclude class certification.

5. Conclusion

For the foregoing reasons, the Court finds that Plaintiff has satisfied all four "prerequisites" of Rule 23(a).

B. Rule 23(b)

Next the Court considers whether Plaintiff has satisfied one of the requirements of Rule 23(b). According to Plaintiff, it can establish that "questions of law or fact common to class members predominate over any questions affecting only individual members." *See* Fed. R. Civ. P. 23(b). However, Defendants disagree, reasoning that because the class claims sound in fraud, each individual will have to prove that they relied on the alleged actionable misrepresentations and omissions. Consequently, they argue, since reliance is a highly individualized inquiry, class certification should be denied because individual questions regarding reliance will predominate over common questions. *Basic, Inc. v. Levinson*, 485 U.S. 224, 242, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988) ("Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones."); *see also Binder v. Gillespie*, 184 F.3d 1059, 1063 (9th Cir. 1999).

Now it is Plaintiff's position that reliance can be presumed in this case, which is why the Court can reject Defendants' argument that the individualized reliance inquiry precludes class certification. However, whether reliance can be presumed in this case depends on whether Plaintiff can properly avail itself of what is commonly referred to as the "fraud-on-the-market" theory. Formally adopted by the Supreme Court in

Basic, the "fraud-on-the market" theory "is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business .... Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements ...." *Binder*, 184 F.3d at 1064 (quoting *Basic*, 485 U.S. at 241-42). "Thus, the presumption of reliance is available only when a plaintiff alleges that a defendant made material representations or omissions concerning a security that is actively traded in an 'efficient market,' thereby establishing a 'fraud on the market.'" *Binder*, 184 F.3d at 1064 (citing *Basic*, 485 U.S. at 247); This presumption of reliance can, however, be rebutted. *Basic*, 485 U.S. at 248.

The parties disagree over exactly what type of showing Plaintiff must make in order for the presumption of reliance to be triggered. According to Defendants, at the very least, Plaintiff must allege and prove the following:

> (1) that the defendant made public misrepresentations; (2) that the misrepresentations were material; (3) that the shares were traded on an efficient market; (4) that the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and (5) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed.

See Basic, 485 U.S. at 248 n.27. Defendants also urge the Court to follow a rule that the Fifth Circuit recently adopted in *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007). In

that case, the Fifth Circuit held that a plaintiff may recover under the fraud-on-the-market theory only if she can "prove that the defendant's non-disclosure materially affected the market price of the security." *Id.* at 265. In other words, plaintiffs must "establish loss causation in order to trigger the fraud-on-the-market presumption." *Id.*[10]

Plaintiff, on the other hand, contends that it has to make a substantially lesser showing. More specifically, Plaintiff argues that it need not prove the five elements listed by Defendants in their brief and found within a footnote in *Basic* (i.e., the "*Basic* footnote elements"). No[r] does it have to prove loss causation in order to trigger application of the presumption. Rather, Plaintiff claims that it need only prove "market efficiency."[11]

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[10] "Loss causation" is a term used to describe the requirement that a private plaintiff who claims securities fraud must prove that the defendant's fraud in fact caused an economic loss. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 388, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005) (citations omitted).

[11] Put simply, a market is efficient if the stock prices reflect public information. *Binder*, 184 F.3d at 1065. Although the Ninth Circuit has not articulated a specific test for market efficiency, it and district courts in this circuit have looked to the factors articulated in *Cammer v. Bloom*, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989), which included both direct and indirect tests for efficiency. *See, e.g., Binder*, 184 F.3d 1059; *In re Surebeam Corp. Sec. Litig.*, 2005 WL 5036360, *23 (S.D. Cal. 2005). These factors include (1) whether the stock trades at high weekly volume; (2) whether securities analysts follow and report on the stock; (3) whether the stock has market makers and arbitrageurs; (4) whether the company is eligible to file a Form S-3 registration statement with the SEC; and (5) whether there are empirical facts showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock rice. *See Cammer*, 711 F. Supp. at 1286-87.

Plaintiff also contends that it would be "legal error" if this Court inquired into issues that go to the heart of its claims, such as whether the alleged misrepresentations made by Defendants were material.

In any event, Defendants argue, even if Plaintiff need only prove that it purchased its securities on an efficient market, Defendants can adequately rebut this presumption.

In resolving the dispute at hand, it is helpful to separate the analysis into three inquiries. First, is it necessary for Plaintiff to establish the *Basic* footnote factors in order to trigger the presumption? Second, does Plaintiff have to prove loss causation to apply that presumption? And, lastly, assuming the presumption applies, have Defendants presented adequate evidence to rebut the presumption?

1. Triggering the Presumption

In support of their position that Plaintiff must establish the *Basic* footnote elements, Defendants point to the specific language the Supreme Court used in the *Basic* footnote: "The Court of Appeals held that in order to invoke the presumption, a plaintiff must allege *and prove*" five different elements. *Basic*, 485 U.S. at 248 n.27 (emphasis added). Seizing on the word "prove," Defendants contend that *Basic* requires Plaintiff to show much more than an efficient market. In other words, Defendants read this footnote as a mandate.

Other courts, both within and outside of this circuit, have similarly interpreted *Basic*. *See, e.g.*, *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 197 (6th Cir. 1990); *In re Cooper Cos., Inc. Sec. Litig.*, 254 F.R.D. 628, 638 (C.D. Cal. 2009). Now while these interpretations are

not in conflict with *Basic* (i.e., nothing in *Basic* tells lower courts that they cannot consider those five elements listed in the footnote), the Court nevertheless finds this interpretation to be unsupported by the language in the opinion. Noticeably absent from the relevant footnote is any type of mandatory language, such as "must," that would otherwise compel lower courts to apply a five element test. Also, it is significant that the footnote is not framed as a command or a directive. Rather, it appears to be more of an observation, suggesting to lower courts an approach that they might, but need not, adopt when applying the presumption.

This Court's interpretation of Basic appears to be supported by two Ninth Circuit decisions, the first being *Binder*, 184 F.3d 1059.[12] In *Binder*, the Ninth Circuit reviewed the district court's decision to decertify the class through a certain time period because the plaintiff had failed to establish market efficiency. *Id.* at 1064. After explaining the assumptions underlying the fraud-on-the-market theory, the Ninth Circuit observed, "[T]he presumption of reliance is available only when a plaintiff alleges that a defendant made material representations or omissions concerning a security that is actively traded in an 'efficient market,' thereby establishing a 'fraud on the market.'" *Id.* Notably, while

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[12] Surprisingly, it appears that the Ninth Circuit has only twice considered what type of showing a plaintiff must make to trigger the presumption at the class certification stage. This is not to say, however, that the Ninth Circuit has not addressed the fraud-on-the-market theory in other contexts. Indeed, on numerous occasions the Ninth Circuit has addressed this theory at the summary judgment stage. *See, e.g., Provenz v. Miller*, 102 F.3d 1478 (9th Cir. 1996); *Kaplan v. Rose*, 49 F.3d 1363 (9th Cir. 1994); *In re Apple Computer Sec. Litig.*, 886 F.2d 1114 (9th Cir. 1989).

the Ninth Circuit uses the word "alleges," it is clear that a plaintiff actually needs to produce some evidence on this issue for later in its decision the Ninth Circuit reviewed the evidence proffered by the petitioner to support his argument that the market was in fact efficient and ultimately found that evidence to be insufficient. *See id.* at 1065.

If there was any doubt as to what type of showing was needed in order to make the presumption available, that doubt was laid to rest with the very recent unpublished decision of *Huberman v. Tag-It Pac., Inc.*, 314 Fed. Appx. 59 (9th Cir. 2009). In *Huberman*, the Ninth Circuit again took up the issue of whether a district court had properly applied the presumption at the class certification stage. This time, though, the Ninth Circuit found that the presumption was properly applied because "at this stage of the proceeding, Huberman satisfied Rule 23(b)(3)'s superiority requirement by presenting evidence that Tag-It traded on an efficient market, thereby establishing the application of the fraud-on-the-market presumption." *Id.* at *63. The court went on to explain:

> The fraud-on-the-market presumption is only available when the plaintiff demonstrates that the security which the defendant's allegedly fraudulent behavior concerned was actively traded in an efficient market.
>
> . . .
>
> Here, where Tag-It was traded on a national exchange and the stock prices reflected public information an efficient market is present. Therefore, the fraud-on-the-market presumption applies, eliminating the need for individual reliance by each class member.

Id. (internal citations omitted).

Noticeably absent from both *Binder* and *Huberman* is any discussion of the *Basic* footnote elements. Indeed, the analysis of this issue in both of these decisions is, to put it fairly, extremely limited.

Importantly, in the past two years, at least two district courts in this circuit have concluded that once a plaintiff establishes that an efficient market existed, the presumption is triggered. In *In re Connetics Corp. Sec. Litig.*, 2009 U.S. Dist. LEXIS 39914 (N.D. Cal. 2009), the district court, in response to very similar arguments that have been made here, found that "at this stage [i.e., the class certification stage], lead plaintiff need show only that it traded on an efficient market." *Id.* at *19 (emphasis added). Likewise, in *In re Micron Techs., Inc.*, 247 F.R.D. 627 (D. Idaho 2007), the district court, citing to *Binder*, observed that a plaintiff need "only" establish that the shares at issue were traded on an efficient market in order to trigger the presumption. *Id.* at 633.[13]

The reasoning of the *Binder*, *Huberman*, *Connetics*, and *Micron* courts is consistent with well-established precedent that counsels against inquiries into the merits of a plaintiff's case at the class certification stage. Since 1974, courts have been particularly careful not to analyze the merits of a lawsuit when presented with a motion for class certification. That year, the Supreme Court famously stated, "We find nothing

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[13] However, at least two other district courts have found that plaintiffs must establish the *Basic* footnote elements in order to trigger the fraud-on-the-market presumption. See *In re LDK Solar Sec. Litig.*, 255 F.R.D. 519, 526 (N.D. Cal. 2009); *In re Cooper*, 254 F.R.D. at 639.

in either the language or history of Rule 23 that gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action." *Eisen*, 417 U.S. at 177-78. Now this Court recognizes that over the years the lower courts have refined the scope of review established by *Eisen*. In fact, under controlling Ninth Circuit precedent, this Court is not only "at liberty to" but must "consider evidence which goes to the requirements of Rule 23 [at the class certification stage] even [if] the evidence may also relate to the underlying merits of the case." *Hanon*, 976 F.2d at 509. Nevertheless, the Court must do so only when the evidence goes to the requirements of Rule 23. *Id.* Here, this Court finds that the inquiries Defendants urge the Court to make do not concern the requirements of Rule 23, but instead concern the merits of the case. Accordingly, delving into those issues is inappropriate at this time.

2. Oscar

For similar reasons, the Court declines Defendants' invitation to adopt the rule of *Oscar*. As another court recently noted, "*Oscar* has not been considered or adopted by the Ninth Circuit [and] [i]t is unlikely that it would be adopted in this Circuit because it misreads *Basic*." *In re Micron Techs., Inc.*, 247 F.R.D. at 634. This Court agrees.

Essentially, *Oscar* is premised on the *Basic* Court's discussion of how defendants can rebut the presumption of reliance. Towards the end of its opinion in *Basic*, the Supreme Court explained that "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance."

Basic, 485 U.S. at 248. Subsequently, the Supreme Court went on to provide specific examples of what type of showing could sever the link. For instance, a showing that the "market makers" were privy to the truth would provide a sufficient basis for finding that the fraud had not been transmitted through the market. *Id.* The presumption would also not apply if a defendant could show that the plaintiff would have divested himself of his shares without relying on the integrity of the market. *Id.* at 249.

The Fifth Circuit interpreted *Basic* to require plaintiffs to prove at the class certification stage that "it is more probable than not" that the corrective disclosure—the revealing of the secret—made a "significant contribution to a price decline." *Oscar*, 487 F.3d at 270. In other words, in the Fifth Circuit, plaintiffs must prove loss causation to be entitled to class certification. *Id.* However, as other courts have noted, this interpretation is actually contradicted by *Basic*.[14] In the heart of the Supreme Court's discussion of what type of showing a defendant can make to rebut the presumption, the Supreme Court drops a crucial footnote, in which it states that "[p]roof of this sort is a matter for trial ... ." *Basic*, 485 U.S. at 245 n.29. Thus, as one court aptly put it:

> An accurate reading of *Basic* places a requirement on plaintiffs, at the class certification

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[14] A number of courts outside the Fifth Circuit have considered *Oscar* and declined to follow it. *See, e.g., In re LDK Solar Sec. Litig.* 584 F. Supp. 2d 1230, 1251 (N.D. Cal. 2008); *In re Credit Suisse-AOL Sec. Litig.*, 253 F.R.D. 17, 29 (D. Mass. 2008); *In Re Nature's Sunshine Prods. Inc. Sec. Litig.*, 251 F.R.D. 656, 665 (D. Utah 2008) (citing other examples).

> stage, to show that the market was efficient. The plaintiffs' proffer of evidence concerning efficiency must be rigorously examined by the Court before finding that they are entitled to a presumption of reliance. While defendants are entitled to rebut that presumption, that issue is appropriate for resolution only after discovery.

In re Micron Techs., Inc., 247 F.R.D. at 634.

In summary, the Court agrees with Plaintiff that to trigger the presumption of reliance, Plaintiff need only establish that an efficient market exists. Other inquiries into issues such as materiality and loss causation are properly taken up at a later stage in this proceeding.

On this note, it appears that there is in fact no dispute as to whether Plaintiff has established that an efficient market exists. Indeed, not only have Defendants admitted that "the market for Amgen securities was an efficient market," *compare CAC* ¶ 199 *with Defs.' Answer and Affirmative Defenses* at 199 (Dkt. #149), but Plaintiff has also met the aforementioned *Cammer* factors through the report of its expert, Scott D. Hakala, which Defendants do not challenge.[15] *See McDonald Decl.* Ex. 7. Accordingly, because Plaintiff has established that it purchased its securities on an efficient market, it is entitled to a presumption of reliance.

3. Rebuttal

Defendants also contend that assuming the presumption applies in this case, they can adequately rebut

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[15] The Court notes that Defendants do not dispute Hakala's qualifications to opine on market efficiency, but reserve their right to challenge his qualifications to opine on other issues.

that presumption by showing that the "truth" was known to the market. Although unclear from their briefs, it appears that Defendants want to apply a principle that some courts have termed the "truth-on-the-market" doctrine. *Provenz*, 102 F.3d at 1492. The "truth-on-the-market" doctrine essentially maintains that in a fraud-on-the-market case, "an omission is materially misleading only if the information has not already entered the market." *In re Convergent Techs. Sec. Litig.*, 948 F.2d 507, 513 (9th Cir. 1991) (citing *Apple Computer*, 886 F.2d at 1114). As the Ninth Circuit has explained, "[i]f the market has become aware of the allegedly concealed information, 'the facts allegedly omitted by the defendant would already be reflected in the stock's price' and the market 'will not be misled.'" *Id.* (quoting *Apple Computer*, 886 F.2d at 1114).

Defendants argue that they can adequately rebut the presumption as it relates to three different time periods, the first of which is the time period between April 22, 2004 and December 1, 2006.[16] According to Defendants, during this time period, the market was well aware of the "truth" that there were serious safety concerns with regard to Amgen's ESAs. In support of this contention, Defendants point to an announcement made by the FDA in March 2004 that it was convening a meeting with the ODAC in May of that year to discuss, among other things, "safety concerns associated with ARANESP (darbepoetin alfa) Amgen, Inc. and

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[16] April 22, 2004 is the commencing date of the Class Period and the day when Morrow allegedly "downplayed the significance of the [upcoming 2004 ODAC] meeting and the safety concerns of the FDA." *CAC* ¶ 58. December 1, 2006 is the date when the DAHANCA 10 investigators terminated the study entirely. *Id.* at ¶ 65.

PROCRIT (epoetin alfa) Ortho Biotech, L.P." Defendants argue that this announcement, as well as the May 4, 2004 ODAC Meeting itself, served to inform the market that there were safety concerns with respect to Aranesp. As evidence of the market's awareness, Defendants point to a sample of analyst reports issued on May 5, 2004, in which the analysts discuss the ODAC Meeting. *See, e.g.*, RJN Ex. 13 (Banc of America report); RJN Ex. 15 (Lehman Bros. report).

Defendants also claim that they can rebut the presumption as it applies to the period of time between December 1, 2006 and February 16, 2007, otherwise known by the parties as "the DAHANCA period." According to Plaintiff, the DAHANCA period holds relevance in this case because it encompasses the period between when Defendants first learned of the termination of the DAHANCA 10 study (December 1, 2006) and the time *The Cancer Letter* published an article regarding the DAHANCA results (February 16, 2007). This latter event, according to Plaintiff, was the first time the negative results of the DAHANCA 10 study became public. However, Defendants argue that news of the termination of the study was already accessible on the Internet and, therefore, the public could not have been misled since the alleged misstatement and omission were already in the public forum. *See McDonald Decl.* Ex. 3 (*The Cancer Letter* Article) ("[E]ven informed observers have been largely unaware that the Danish study was temporarily stopped on Oct. 18, 2006, and that the decision not to resume the study was made on Dec. 1, 2006, and posted on the Web by the principal investigator, Jens Overgaard.").

Lastly, Defendants argue that they can rebut the presumption as it applies to the time period between February 16, 2007 and May 10, 2007, the date on which

ODAC voted to recommend that additional restrictions be placed on the use of Amgen's ESAs. *See* RJN Ex. 75. Defendants point to certain disclosures they made after *The Cancer Letter* published the article about the termination of the DAHANCA 10 study. For example, on February 28, 2007, Amgen announced that it had been contacted by the SEC regarding the DAHANCA 10 study, and that it had been invited to participate in the May 10, 2007 ODAC meeting. *See* RJN Ex. 48 (Amgen press release). That same day, Defendants also announced that Amgen was "in discussions with the FDA" regarding a "boxed warning" for Amgen's ESA products. *See id.* Just two weeks after making these announcements, the FDA released a statement that it would require a boxed warning for Aranesp and Epogen. *See* RJN Ex. 66 (FDA news release). As Defendants see it, all of these disclosures are evidence that by the time of the May 10, 2007 ODAC Meeting, the market was well aware of all concerns discussed at the meeting.

Plaintiff takes issue with Defendants' contentions for essentially two reasons. First and foremost, Plaintiff argues that while Defendants do have an opportunity to rebut the presumption, they may only do so at a stage in the proceedings after class certification. Second, Plaintiff contends that the "truth-on-the-market" doctrine cannot be applied because Defendants cannot prove that the information that was withheld or misrepresented was "'transmitted to the public with a degree of intensity and credibility sufficient to effectively counterbalance any misleading impression created by insider's one-sided representations.'" *Kaplan*, 49 F.3d at 1376 (quoting *Apple Computer*, 886 F.2d at 1116). In other words, Plaintiff is arguing that the truth was not in fact on the market.

On review, the Court agrees with Plaintiff that now is an inappropriate time to consider Defendants' contentions. As noted above, when explaining exactly how a defendant could rebut the presumption of reliance in a fraud on the market case, the Supreme Court provided several examples of sufficient showings. *Basic*, 485 U.S. at 249. However, immediately after providing these examples, the Supreme Court noted that proof of these examples "is a matter for trial." *Id.* at 249 n.29. Now in the years since *Basic* was first decided, it has become clear that, at least in this circuit, defendants can indeed rebut the presumption at the summary judgment stage. *See, e.g., Hanon*, 976 F.2d at 506-07. However, Defendants have failed to point this Court to one Ninth Circuit decision wherein the Ninth Circuit approved of a lower court's decision to analyze the evidence proffered by a defendant to rebut the presumption. To a degree, this does not come as a surprise to the Court. After all, it has long been established in this circuit that "the defense of non-reliance is not a basis for denial of class certification." *See id.* at 508 (citing *Blackie*, 524 F.2d at 901 n.17; *In re Pizza Time Theatre Sec. Litig.*, 112 F.R.D. 15, 22 (N.D. Cal. 1986)). Thus, if this Court was to allow Defendants to present evidence that none of the investors were misled because the truth was on the market, the Court would essentially be allowing Defendants to assert a defense of non-reliance as a basis for denial of class certification. But such is not allowed. *See Hanon*, 976 F.2d at 506-07.

4. Superiority

Having decided that common questions of fact and law predominate over individual questions, the Court must now decide whether class resolution is "superior to other available methods for the fair and efficient ad-

judication of the controversy." Fed. R. Civ. P. 23(b)(3). Clearly, it is. In this case, the alternative methods of resolution are individual claims for damages that may likely be outweighed by the costs of litigation. Thus, absent a class action, it is unlikely that many of the class members would prosecute their claims.

The parties also appear to agree that there are presently no management or administration issues that would cause difficulties going forward or at trial. If anything, the judicial system would suffer greater strain if this Court was to deny certification, as there is a possibility that the judicial system would become inundated with thousands of identical complaints.

For the foregoing reasons, the Court finds that class resolution is indeed "superior to other available methods for the fair and efficient adjudication of the controversy."

C. Class Period

Lastly, the Court considers Defendants' argument that the Court should deny certification because there is no basis for the Class Period. This argument can be rejected for the same reasons that the Court rejected Defendants' other arguments in this case—namely, Defendants, in direct contravention of a long line of authority, are attempting to improperly advance a decision on the merits to the class certification stage. *See Staton*, 327 F.3d at 954 ("[I]t is improper to advance a decision on the merits to the class certification stage."). As many other district courts have held, evidentiary disputes concerning the commencement and termination dates of a proposed class period raise questions of fact going to the merits of the case, and are therefore not a proper subject for inquiry at the certification

stage. *See, e.g., In re Cooper*, 254 F.R.D. at 640; *In re Unioil*, 107 F.R.D. at 621; *In re SciMed Secs. Litig.*, 1993 WL 616692 (D. Minn. Sept. 29, 1993); *Weinberger v. Thornton*, 114 F.R.D. 599, 605 (S.D. Cal. 1986); *In re Victor Techs. Sec. Litig.*, 102 F.R.D. 53, 58 (N.D. Cal. 1984) ("Examining whether a document issued during the proposed class period 'effectively cured' an alleged earlier misrepresentation calls for ... a proscribed inquiry into the merits.").

In summary, the issue of the appropriate commencement and termination dates for the class period can be resolved only by an inquiry into the merits of the suit, which is prohibited at this stage in the proceedings. Accordingly, the Court finds that Plaintiff has sufficiently established the Class Period.

IV. Defendants' Evidentiary Objections and Request to Strike

In addition to opposing Plaintiff's motion for class certification, Defendants have also filed evidentiary objections and a request to strike the references to allegations attributed to certain confidential witnesses from footnote 9 of Plaintiff's motion, as well as from Plaintiff's complaint. These allegations concern the off-label marketing scheme allegedly implemented by Defendants.

According to Plaintiff, Amgen, through press releases, repeatedly stated that it only promoted the use of its ESAs consistent with the FDA label. However, Plaintiff alleges that Amgen had in fact developed a sophisticated and multifaceted scheme to improperly push the ESAs for unapproved indications and popula-

tions.[17] *CAC* ¶¶ 81, 84. This scheme included, among other things: (1) training Amgen sales representatives to prompt doctors to ask questions that would permit them to begin the off-label dialog regarding Aranesp and Epogen, *id.* at ¶ 85; (2) creating a "speakers program" to boost off-label sales, wherein Amgen hired "expert" speakers to talk about off-label uses of Aranesp to physicians and other medical service providers, who received a $1,000 honorarium "paid from marketing budget" upon Amgen's receipt of their program evaluations, *id.* at ¶ 89; (3) soliciting business by marketing increased drug dosages, such as encouraging doctors to inject Epogen intravenously rather than subcutaneously, which requires a smaller dose to achieve the same therapeutic effect, *id.* at ¶¶ 92-93; (4) marketing Epogen and Aranesp to physicians and other medical service providers, by explicitly discussing the financial benefits of prescribing high volumes of these drugs, in violation of Medicare regulations, *id.* at ¶ 100; and (5) providing spreadsheets and other tools to enable sales representatives to calculate "margin and spread," *i.e.* the profit that a medical practice could earn by using particular Amgen drugs in combination. *Id.* at ¶ 101. These allegations were originally provided by five confidential witnesses. Later, though, the identity of one of these witnesses, Diego E. Naranjo ("Naranjo") was disclosed to Defendants.

According to Defendants, Plaintiff breached an agreement to not rely on the allegations of the unidenti-

---

[17] The FDA does not prohibit physicians from prescribing drugs for unapproved, off-label uses. However, drug companies may provide information regarding off-label uses *only* in response to physician inquiries.

fied confidential witnesses in prosecuting its motion for class certification by relying on these witnesses' allegations in footnote 9 of page 7 of its moving papers. In light of this, Defendants argue, the Court should not consider any allegations or claims attributed to the unidentified confidential witnesses. Defendants also request that the Court strike footnote 9 and the off-label marketing allegations in the complaint altogether.

In support of its position, Defendants cite to a letter written by Plaintiff's counsel and addressed to Defendants' counsel. In this letter, Plaintiff's counsel writes:

> [I] will restate [our position] to more clearly account for defendants' requested bifurcation of the issue: plaintiff will not rely on CWs 2 through 5 for purposes of filing its initial papers in support of class certification. If defendants forbear from seeking to identify, depose and use testimony by CWs 2 through 5 at the class certification stage, plaintiff will not rely on CWs 2 through 5 in its reply papers either.

Kramer Decl. Ex. 3. However, what Defendants fail to point out is that Plaintiff's counsel continues:

> Your draft letter-agreement also seeks confirmation that plaintiff will not "rely" on "any allegations attributed to" CWs 2 through 5 for purposes of seeking class certification. The only extent to which Plaintiff intends to rely on the Complaint's marketing-related allegations is in connection with plaintiff's argument to the Court that they present common questions that make class treatment appropriate.

Id.

Defendants' objection and request is based on the premise that Plaintiff supposedly "promise[d] not to rely on Confidential Witnesses 2-5" while moving for class certification[.] *Defs.'s Brief* at 4. However, as Plaintiff correctly points out, it never promised any such thing. Indeed, in his letter, Plaintiff's counsel unequivocally states that Plaintiff was in fact planning on relying on these allegations, albeit only "in connection with plaintiff's argument to the Court that they present common questions that make class treatment appropriate." *See Kramer Decl.* Ex. 3. Thus, the premise on which Defendants' base their objections and request is faulty.

So too is the premise of another argument made by Defendants. Essentially, Defendants believe that Plaintiff has not produced enough evidence to demonstrate that Defendants did in fact engage in unlawful off label marketing schemes, which, according to Defendants, is sufficient reason to deny the motion for class certification in that respect. But, again, Defendants misunderstand the showing that Plaintiff needs to make at this stage in the proceedings. Plaintiff has introduced evidence that Defendants represented that they did *not* engage in such unlawful practices. That evidence, when combined with the allegations in the complaint—allegations which this Court must take as true at this stage in the proceedings, *see Blackie*, 524 F.3d at 901—is sufficient to move Plaintiff past the class certification stage.[18]

---

[18] Of course, assuming that these allegations cannot be substantiated, then certainly Plaintiff's claims of off-label marketing policies will fail. However, questions of that sort, i.e., questions that go to the merits of a claim, are properly addressed at a later stage in the proceeding.

For the foregoing reasons, the Court rejects Defendants' request to strike the references to the allegations attributed to the unidentified confidential witnesses from footnote 9 of Plaintiff's motion, as well as from the complaint.

IV. Conclusion

Based on the foregoing, the Court GRANTS Plaintiff's Motion for Class Certification.

IT IS SO ORDERED.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Plaintiff-Appellee,

v.

AMGEN INC.; et al.,
Defendants-Appellants.

No. 09-56965
D.C. No. 2:07-cv-02536-PSG
Central District of California,
Los Angeles

[STAMP: Filed DEC 28 2011]

ORDER

Before: SILVERMAN and WARDLAW, Circuit Judges, and SESSIONS, District Judge.*

Washington Legal Foundation and Allied Educational Foundation's motion for leave to file an amicus brief in support of appellants' petition for rehearing en banc is GRANTED.

Judges Silverman and Wardlaw have voted to deny appellants' petition for rehearing en banc, and Judge Sessions so recommends.

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* The Honorable William K. Sessions III, District Judge for the U.S. District Court for Vermont, sitting by designation.

The full court has been advised of the petition for rehearing en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

Appellants' petition for rehearing en banc is DENIED.

APPENDIX D

STATUTORY PROVISIONS AND RULES

Section 10(b) of the Securities and Exchange Act of 1934

15 U.S.C. § 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

* * *

Section 20(a) of the Securities and Exchange Act of 1934

15 U.S.C. § 78t. Liability of controlling persons and persons who aid and abet violations

(a) Joint and several liability; good faith defense

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable (including to the Commission in any action brought under paragraph (1) or (3) of section 78u(d) of this title), unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

* * *

Securities and Exchange Rule 10b-5, 17 C.F.R. § 240.10b-5

17 C.F.R. § 240.10b–5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Federal Rules of Civil Procedure

Rule 23. Class Actions

(a) Prerequisites. One or more members of a class may sue or be sued as representative parties on behalf of all members only if:

(1) the class is so numerous that joinder of all members is impracticable;

(2) there are questions of law or fact common to the class;

(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and

(4) the representative parties will fairly and adequately protect the interests of the class.

(b) Types of Class Actions. A class action may be maintained if Rule 23(a) is satisfied and if:

(1) prosecuting separate actions by or against individual class members would create a risk of:

(A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or

(B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;

(2) the party opposing the class has acted or refused to act on grounds that apply generally to the

class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or

(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:

(A) the class members' interests in individually controlling the prosecution or defense of separate actions;

(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

(D) the likely difficulties in managing a class action.

* * *

(f) Appeals. A court of appeals may permit an appeal from an order granting or denying class-action certification under this rule if a petition for permission to appeal is filed with the circuit clerk within 14 days after the order is entered. An appeal does not stay proceedings in the district court unless the district judge or the court of appeals so orders.

* * *

OPPOSITION BRIEF

RECORD
AND
BRIEFS

Supreme Court, U.S.
FILED
MAY 11 2012
OFFICE OF THE CLERK

No. 11-1085

IN THE
Supreme Court of the United States

AMGEN INC., ET AL.,
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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May 11, 2012

QUESTIONS PRESENTED

The decision below is the first and thus far the only court of appeals decision to consider two recent decisions of this Court, *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011), and *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011), in the context of a Rule 23(f) appeal of an order certifying a class in a misrepresentation case under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), based on the fraud-on-the-market theory. In considering these recent decisions, the court below held that, to satisfy Rule 23(b)(3)'s requirement that common questions "predominate over any questions affecting only individual members," a plaintiff who moves to certify an investor class based on the presumption of reliance under the fraud-on-the-market theory need not show that a defendant's misrepresentation is "material." Rather, if the plaintiff establishes that the market on which the subject security trades is efficient and the misrepresentation was made publicly, materiality is a merits question common to all class members. The court below further held that a defendant may not, at the class-certification stage, rebut the application of the fraud-on-the-market theory by attempting to show that an alleged misrepresentation was not material. The questions presented are:

1. Whether proof of materiality in a securities fraud case predicated on the fraud-on-the-market theory, as posited by Petitioners to be a bright-line rule requiring proof of "price impact," is required for class certification.

2. Whether the Petition should be denied because Petitioners failed to press their "price impact" standard below and offered no quantitative evidence in

support of the "price impact" test they seek to make the subject of review by this Court, and the Ninth Circuit did not pass on that issue.

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STATEMENT OF THE CASE

1. Respondent Connecticut Retirement Plans and Trust Funds ("Connecticut") brought securities fraud claims against Petitioners (collectively, "Amgen") under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78j(b), 78t(a) (App. 53a-54a)) and Securities and Exchange Commission ("SEC") Rule 10b-5 (17 C.F.R. § 240.10b-5 (App. 55a)). This action centers on alleged misrepresentations and omissions Amgen made about two of its flagship products, Aranesp® and Epogen®. Both products are in a drug class known as erythropoiesis-stimulating agents ("ESAs") and have been approved by the U.S. Food and Drug Administration ("FDA") to reduce the need for transfusions in certain patients with anemia, including cancer patients with anemia associated with chemotherapy. App. 16a-17a.[1]

The misrepresentations primarily concern product safety. "Off-label" clinical trial data of ESAs used in Europe raised concerns within the FDA over whether the "on-label" use of ESAs approved for use in the U.S. increased mortality or tumor growth rates in cancer patients.[2] R104-05 V.2 Tab 6. Amgen is alleged to have misrepresented that its ESAs were "safe" when, in fact, the "on-label" use of Aranesp and Epogen produced unknown effects on patient

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[1] References to "App. __" are to the appendix accompanying the certiorari petition. References to "R__ V.__ Tab __" are to the page, volume, and tab number of "Defendants-Appellants' Excerpts of Record" filed by Amgen in the court below.

[2] "On-label" means using the product in accordance with the FDA-approved labeling; "off-label" means for indications, dosage forms, dose regimens, populations, or other use parameters not mentioned in the FDA-approved labeling. R90 V.2 Tab 6.

mortality, tumor growth rates, and other clinically significant events.

The class period begins on April 22, 2004 (App. 16a); in response to a question about an upcoming meeting of an FDA advisory committee to discuss the FDA's on-label safety concerns, Amgen reassured investors by stating that there was no safety "signal" associated with Aranesp and that its safety was "comparable to placebo" in two clinical trials. R105-06 V.2 Tab 6. At the advisory committee meeting itself, held in early May 2004, Amgen specifically sought to allay the FDA's concerns by announcing that Amgen had instituted a program of five clinical trials it described as "a responsible and credible approach to definitively resolving the questions raise[d]" at the meeting concerning ESA safety. R106-07 V.2 Tab 6.

Amgen then repeatedly reassured investors during the class period that Aranesp and Epogen were safe when used on-label (R134-38 V.2 Tab 6), even as additional off-label clinical trials continued to demonstrate various safety problems with ESAs, including Amgen's. R107-113 V.2 Tab 6. Only three weeks before the end of the class period, Petitioner Sharer (Amgen's Chairman and CEO) stated "that on label our drugs are certainly safe" and "[i]t is certainly our very, very strong conviction that our products are very safe when used on label." R91, 137-38 V.2 Tab 6.

The class period ends on May 10, 2007 (App. 16a), the date of a second FDA advisory committee meeting to discuss ESA safety. Contrary to Amgen's reassuring statements and purportedly "responsible and credible" clinical trial program, an FDA official

at the meeting made clear that "no completed or ongoing trial has addressed safety issues of ESAs in cancer patients with chemotherapy-associated anemia using currently approved dosing regimens in a generalizable tumor type." R129 V.2 Tab 6. Another FDA official revealed that Amgen failed to provide the FDA with sufficient data concerning its clinical trial program. R129-30 V.2 Tab 6. The committee recommended that the FDA require ESA manufacturers to conduct further studies and carry stronger warnings on ESA labels. R130 V.2 Tab 6. Amgen's common stock dropped by more than 9% on May 10, 2007. R155 V.2 Tab 6.[3]

On the merits, Amgen contends that it cannot be liable for any of its misrepresentations because the "truth" was already on the market. Pet. 5. However, "not every mixture with the true will neutralize the deceptive," *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097 (1991), and Connecticut alleges that Amgen's deceptive reassurances (which were also, prominently, on the market) had the effect of artificially inflating Amgen's stock price. Until the advisory committee meeting of May 10, 2007, the truth about the *lack* of evidence of "on-label" ESA safety was not "conveyed to the public 'with a degree of intensity and credibility sufficient to counter-

---

[3] Amgen is also alleged to have made actionable misrepresentations and omissions concerning the marketing, revenues, and earnings of Aranesp and Epogen (R138-44 V.2 Tab 6), but these allegations flow from Amgen's misleading statements concerning product safety. *Cf. Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1323 (2011) (statements on revenue and earnings held actionable based on underlying safety issues with defendant's "leading revenue-generating" product). In 2006, Amgen generated roughly half of its $14.3 billion in annual revenue from sales of Aranesp and Epogen. R100 V.2 Tab 6.

balance effectively any misleading information created by' the alleged misstatements" Amgen made that its ESAs were safe when used on-label. *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 167 (2d Cir. 2000) (quoting *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1116 (9th Cir. 1989)).

2. In cases like this "involving publicly traded securities and purchases or sales in public securities markets," *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341 (2005), the six elements that a securities fraud plaintiff ultimately must prove at trial are:

(1) *a material misrepresentation (or omission)*, see *Basic Inc. v. Levinson*, 485 U.S. 224, 231-232 (1988);

(2) *scienter*, *i.e.*, a wrongful state of mind, see *Ernst & Ernst* [*v. Hochfelder*, 425 U.S. 185, 197 (1976)];

(3) *a connection with the purchase or sale of a security*, see *Blue Chip Stamps* [*v. Manor Drug Stores*, 421 U.S. 723, 730-31 (1975)];

(4) *reliance*, often referred to in cases involving public securities markets (fraud-on-the-market cases) as "transaction causation," see *Basic*, *supra*, at 248-249 (non-conclusively presuming that the price of a publicly traded share reflects a material misrepresentation and that plaintiffs have relied upon that misrepresentation as long as they would not have bought the share in its absence);

(5) *economic loss*, 15 U.S.C. § 78u-4(b)(4); and

(6) "*loss causation*," *i.e.*, a causal connection between the material misrepresentation

> and the loss, *ibid.*; cf. T. Hazen, Law of Securities Regulation §§ 12.11[1], [3] (5th ed.2005).

Id. at 341-42 (parallel citations omitted).

In an action brought under Federal Rule of Civil Procedure 23, a plaintiff seeking to certify a class must first satisfy the four prerequisites of Rule 23(a), including Rule 23(a)(2)'s prerequisite that "there are questions of law or fact common to the class," before moving on to the requirements in Rule 23(b). Class actions that proceed under Rule 23(b)(3) require in relevant part that "the court find[] that the questions of law or fact common to class members predominate over any questions affecting only individual members." The two rules operate in tandem. Rule 23(a)(2) addresses whether there exists at least one "common contention . . . of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551 (2011). Rule 23(b)(3), in turn, seeks to determine whether an action possessing at least one such contention "would achieve economies of time, effort, and expense" by proceeding as a class action. Fed. R. Civ. P. 23 advisory committee's note (1966) (subdivision (b)(3)).

To allow plaintiffs in securities class actions involving publicly traded securities to satisfy the predominance requirement of Rule 23(b)(3) when moving for class certification, this Court has "permitt[ed] plaintiffs to invoke a rebuttable presumption of reliance based on what is known as the 'fraud-on-the-market' theory." *Erica P. John Fund, Inc. v. Halli-*

burton Co., 131 S. Ct. 2179, 2185 (2011). Without the presumption, the reliance element in securities fraud actions would make Rule 23(b)(3)'s predominance requirement a significant hurdle: "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would . . . prevent [investors] from proceeding with a class action, since individual issues then would . . . overwhelm[] the common ones." *Basic Inc. v. Levinson*, 485 U.S. 224, 242 (1988).

Central to the fraud-on-the-market theory is the concept of an efficient market:

> According to that theory, "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." Because the market "transmits information to the investor in the processed form of a market price," we can assume . . . that an investor relies on public misstatements whenever he "buys or sells stock at the price set by the market."

Erica P. John Fund, 131 S. Ct at 2185 (quoting *Basic*, 485 U.S. at 244-247) (citation omitted). This Court elaborated on the "efficient market predicate to the fraud-on-the-market theory" (*id.* at 2186) in *Dukes*:

> But the [Rule 23(b)(3) predominance] problem dissipates if the plaintiffs can establish the applicability of the so-called "fraud on the market" presumption, which says that all traders who purchase stock in an efficient market are presumed to have relied on the accuracy of a company's public statements. *To*

> *invoke this presumption, the plaintiffs seeking 23(b)(3) certification must prove that their shares were traded on an efficient market,* an issue they will surely have to prove *again* at trial in order to make out their case on the merits.

131 S. Ct. at 2552 n.6 (citing *Erica P. John Fund*, 131 S. Ct. at 2185) (first emphasis added).

3. In moving for class certification, Connecticut established each of the four prerequisites of Rule 23(a) (App. 22a-31a) and, to satisfy the predominance requirement of Rule 23(b)(3), presented unchallenged evidence that the market for Amgen common stock was efficient. App. 40a. Amgen conceded the point in its answer to Connecticut's complaint.[4]

In opposing class certification, Amgen filed a request for judicial notice ("RJN") that contained 81 exhibits, all of which were described as "publicly available." R1565 V.8 Tab 23. In the district court, Amgen cited the RJN exhibits to oppose the fraud-on-the-market presumption on loss-causation grounds. Specifically, Amgen relied on *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007)—which has since been abrogated by *Erica P. John Fund*—in opposing the presumption. R1350-53 V.7 Tab 11. Amgen's RJN exhibits were

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[4] In answering the complaint, Amgen admitted that "the market for Amgen securities was an efficient market." App. 40a. However, the district court imposed no limitation that precluded Amgen from opposing class certification with evidence to rebut market efficiency. Accordingly, the second of Amgen's "Questions Presented," concerning "whether . . . [a] district court must allow" evidence rebutting the fraud-on-the-market theory, is flawed; Amgen was "allowed" to rebut Connecticut's evidence proving market efficiency but chose not to.

not offered to establish that Amgen investors suffered no losses, but rather to demonstrate that "the market drops that Plaintiff relies on to establish loss causation were not caused by the revelation of any allegedly concealed information." R1350 V.7 Tab 11.[5]

4. The district court granted Connecticut's motion. After acknowledging that it "must conduct as 'rigorous' an analysis as is necessary to determine whether class certification is appropriate" (App. 22a), and after conducting such an analysis, the court found that each of the requirements of Rule 23 had been satisfied. App. 31a. Concerning Rule 23(b)(3), the court found that "Plaintiff has established that it purchased its securities on an efficient market" (App. 40a) and that, as a result, "common questions of fact and law predominate over individual questions." App. 44a. Discussing Amgen's evidence and arguments, the court held that "the inquiries Defendants urge the Court to make do not concern the requirements of Rule 23, but instead concern the merits of the case." App. 38a. The court also noted that Amgen remained able to "rebut the [fraud-on-the-market] presumption at the summary judgment stage." App. 44a.

5. On appeal, Amgen changed course, and opposed the fraud-on-the-market theory not on loss-

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[5] The RJN exhibits consisted of analyst reports, press releases, news articles, transcripts and a slide presentation from earnings calls, articles published in medical journals, filings with the SEC, documents available on the FDA's website, an interim analysis of a clinical trial involving Aranesp, letters sent to legislators or regulators, and a lone stock price chart showing the closing stock price for Amgen on May 9, 2007, and Amgen's intraday stock prices for May 10, 2007—the last day of the class period. R1565-75 V.8 Tab 23.

causation grounds, but by relying for the first time on materiality as a "necessary element" of the presumption. Defendants-Appellants' Opening Brief at 19 (filed Mar. 26, 2010) ("Pet'rs C.A. Br."), 2010 WL 4316245. Amgen argued that the publicly available exhibits in its RJN "demonstrated the market was already aware of the information concerning Aranesp® and Epogen® that Defendants allegedly misstated or concealed, thus rendering the alleged misstatements and omissions not material as a matter of law." *Id.* at 2. Amgen again relied on *Oscar*, but only to support the argument that it could rebut the fraud-on-the-market presumption at the class-certification stage. Amgen also cited *In re Salomon Analyst Metromedia Litigation*, 544 F.3d 474 (2d Cir. 2008), in support of that argument. *See* Pet'rs C.A. Br. 27 n.12, 37, 40; Defendants-Appellants' Reply Brief at 17 n.9, 19 & n.10 (filed June 9, 2010), 2010 WL 4316251.[6]

The court below affirmed. App. 13a. Relying on this "Court's more recent formulations of the [fraud-on-the-market] presumption in *Erica P. John Fund* and *Dukes*," the court "join[ed] the Third and Seventh Circuits" in holding that plaintiffs must demonstrate two things to avail themselves of the fraud-on-the-market presumption at the class-certification stage: (1) "that the security in question was traded in an efficient market (a fact conceded here)," and (2) "that the alleged misrepresentations were public (a fact not contested here)." App. 2a, 11a. "As for the element of materiality, the plaintiff

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[6] Although *Salomon* had been published seven months before Amgen opposed class certification in the district court, Amgen did not cite *Salomon* in its brief. *See* R1321-57 V.7 Tab 11.

must plausibly allege—but need not prove at this juncture—that the claimed misrepresentations were material." *Id.* Because "the only elements a plaintiff must prove at the class certification stage are whether the market for the stock was efficient and whether the alleged misrepresentations were public—issues that Amgen does not contest here"—"the district court correctly refused to consider Amgen's truth-on-the-market defense at the class certification stage." App. 13a. The court below also denied Amgen's request for *en banc* review. App. 51a-52a.

REASONS FOR DENYING THE PETITION

Certiorari is not warranted in this case for four reasons. First, no mature, irreconcilable conflict exists among the courts of appeals on either question presented by Amgen. The decision below is the first decision by any court of appeals to address those questions in the aftermath of *Dukes*, *Erica P. John Fund*, and *Matrixx*—decisions this Court issued barely one year ago. The reasoning and holding of the decision below are correct and consistent with these recent decisions. All of the other court of appeals cases cited by Amgen predate these key recent decisions, and one was abrogated by and is currently being reconsidered in light of *Erica P. John Fund*. This Court's most recent cases make clear that the decision below is correct: if public statements are made in an efficient market, the materiality of the statements affects all purchasers similarly. There is thus no error, and no circuit conflict, warranting this Court's review.

Second, no court of appeals that has squarely considered the question whether a district court must make a determination on materiality, as defined by

Basic, before certifying a fraud-on-the-market securities class action has issued a holding contrary to the decision below. Amgen's claimed circuit split rests on strained readings of *dicta* rather than settled holdings. Any disagreement among the courts of appeals is, at best, a shallow and undeveloped one. Accordingly, this case does not present a square conflict necessitating this Court's review. *See Bunting v. Mellen*, 541 U.S. 1019, 1023 (2004) (Scalia, J., dissenting from denial of certiorari) ("We sit, after all, not to correct errors in dicta; '[t]his Court reviews judgments, not statements in opinions.'") (citation omitted; alteration in original).

Third, the Petition presents a poor vehicle for review because Amgen advocates an evidentiary standard that it made no effort to meet in the courts below. Specifically, Amgen introduced no evidence demonstrating that the misrepresentations alleged in the complaint did not measurably impact the market price of Amgen stock. As a result, Amgen did not create a record sufficient to afford it relief under the rule it propounds in this Court.

Fourth, the questions presented are not of sufficient national importance to warrant this Court's intervention, especially on the heels of this Court's recent decisions in *Dukes*, *Erica P. John Fund*, and *Matrixx*. At core, Amgen and its *amici* are not making a legal argument, but are requesting that the rules be changed on public policy grounds. They seek to engineer a fourth bite at the apple because the three existing procedural junctures for dismissing claims on materiality grounds (Rule 12 motions, Rule 56 motions, and trial) apparently are not enough. Tellingly, the pressures of settlement are discussed in the Petition sooner than (and twice as often as)

Rule 23(b). *Compare* Pet. 3, 9, 14, 15 & n.6, 17, 23 *with* Pet. 5, 6, 10, 11, 26. But Amgen and its *amici* articulate no legitimate public policy concerns that merit departing from the proper application of Rule 23(b)(3).

I. There Is No Mature, Irreconcilable Conflict

Amgen contends that the decision below conflicts with the decisions of the Second and Fifth Circuits in *Salomon* and *Oscar*, and a Third Circuit decision, *In re DVI, Inc. Securities Litigation*, 639 F.3d 623 (3d Cir. 2011). Pet. 9-11.[7] However, the supposed circuit split is illusory and does not warrant this Court's intervention. First, the asserted circuit split is not mature given that none of the other circuits cited by Amgen has yet had an opportunity to consider this Court's recent and highly relevant decisions in *Dukes*, *Erica P. John Fund*, and *Matrixx*. Second, *Oscar*, *Salomon*, and *DVI* do not irreconcilably conflict with the decision below.

A. The Decision Below Is The Only Decision To Apply This Court's Recent Precedents To The Questions Presented

1. The Decision Below Correctly Applied *Dukes* And *Erica P. John Fund*

The Ninth Circuit was the first and thus far only court of appeals to apply this Court's recent

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[7] Although Amgen cites statements by the First Circuit in *In re PolyMedica Corp. Securities Litigation*, 432 F.3d 1, 7 n.11 (1st Cir. 2005), and the Fourth Circuit in *Gariety v. Grant Thornton, LLP*, 368 F.3d 356, 364 (4th Cir. 2004), that plaintiffs must show materiality to gain the benefit of the presumption of reliance, Amgen correctly acknowledges that these statements are *dicta* (Pet. 11 n.2) and does not rely on them as evidence of a mature circuit split.

holding in *Dukes* to address whether materiality must be established or may be rebutted at the class-certification stage. The court below correctly applied *Dukes* in holding that, once an efficient market is demonstrated, materiality is an issue that is common to the class and therefore need not be demonstrated as a condition to class certification.

As this Court held in *Dukes*:

> What matters to class certification . . . is not the raising of common "questions"—even in droves—but, rather the capacity of a classwide proceeding to generate common *answers* apt to drive the resolution of the litigation. Dissimilarities within the proposed class are what have the potential to impede the generation of common answers.

131 S. Ct. at 2551 (quoting Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 132 (2009)).

Applying that standard, the court below correctly recognized that "proof of materiality is not necessary to ensure that the question of reliance is common among all prospective class members' securities fraud claims." App. 12a. Rather, once an efficient market is demonstrated, "falsehood and materiality affect investors alike." *Schleicher v. Wendt*, 618 F.3d 679, 685 (7th Cir. 2010) (Easterbrook, J.). As the court below correctly reasoned, if the statement is material, then all plaintiffs in an efficient market will have relied on it. By contrast,

> if the misrepresentations turn out to be immaterial, then *every* plaintiff's claim fails on the merits (materiality being a standalone merits element), and there would be no need

> for a trial on each plaintiff's individual reliance. Either way, the plaintiffs' claims stand or fall together—the critical question in the Rule 23 inquiry.

App. 8a-9a.

Accordingly, the court below correctly applied *Dukes* in rejecting Amgen's argument that, if misrepresentations were shown to be immaterial, "each individual plaintiff would be left to prove reliance at trial individually—making a class proceeding unwieldy." App. 8a. That argument is flawed, because a finding at the class-certification stage that the alleged false statements were immaterial would not result in an unwieldy class predominated by individual reliance issues; it would defeat reliance for *all* class members. As the court below correctly reasoned, "the plaintiffs cannot both fail to prove materiality yet still have a viable claim for which they would need to prove reliance individually." *Id.* Thus, Amgen's position is incorrect under Rule 23(b)(3) and *Dukes* because answering the materiality question addresses neither whether individual or common issues predominate nor whether a class-wide proceeding has the capacity to generate common answers critical to the resolution of the litigation; it addresses whether *any* plaintiff should win or lose on the merits.

The logic and holding of the court below are entirely consistent with *Dukes*. Because the market in Amgen securities is efficient, the class-action mechanism has "the capacity . . . to generate" a common answer on whether Amgen's misrepresentations were material. 131 S. Ct. at 2551. Resolving materiality at the class-certification stage is inappropriate

because doing so would not expose "[d]issimilarities within the proposed class [with] the potential to impede the generation of common answers." *Id.* Materiality is a "common contention" the determination of which "will resolve an issue that is central to the validity of each one of the claims in one stroke." *Id.*

Likewise, the decision below is consistent with *Erica P. John Fund*, which held that proof of loss causation is not required at the class-certification stage. In its decision, this Court enumerated the "undisputed" required proofs for invoking the "rebuttable presumption of reliance" at the class-certification stage. 131 S. Ct. at 2185. It listed as "common ground" three requirements: that the alleged misrepresentation be public, that the market for the stock be efficient, and that the plaintiff's transaction take place between the time of the alleged misrepresentation and any later corrective disclosure. *Id.*[8] Nowhere did this Court mention materiality. As the court below correctly noted in discussing class-certification requisites, "the Supreme Court's more recent formulations of the presumption in *Erica P. John Fund* and *Dukes* . . . require the plaintiff to show that the stock was traded in an efficient market but do not mention materiality as a requirement." App. 11a (citing *Erica P. John Fund*, 131 S. Ct. at 2185, and *Dukes*, 131 S. Ct. at 2552 n.6).

Because the decision below is the first decision to consider the questions presented in light of *Dukes* and *Erica P. John Fund*, and correctly applied those precedents, certiorari is not warranted until other

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[8] Amgen did not oppose Connecticut's class-certification motion on any of these grounds.

circuits have had an opportunity fully to consider the questions presented in light of those cases and the decision below. Indeed, as discussed below (*see infra* pp. 25-26), the proposed class in the *Erica P. John Fund* case has been certified on remand and that decision is now the subject of a pending Rule 23(f) appeal to the Fifth Circuit.

Further percolation therefore is warranted. If other circuits agree with the Ninth Circuit's reasonable application of this Court's precedents, the need for review is vitiated. If the circuits disagree with the judgment below, the disagreement will have benefited from further refinement and analysis of this Court's recent decisions. Under either scenario, it would be premature for this Court to intercede only a year after *Dukes* and *Erica P. John Fund* were decided.

2. The Decision Below Is Also Consistent With *Matrixx*

The Ninth Circuit did not rely on *Matrixx*, but the decision below is consistent with its holding, which addressed the element of materiality on the merits and did not address any class-certification question. Amgen contends that it should be permitted to "disprov[e] the materiality of the alleged misrepresentation" by establishing that the misrepresentation did not impact the market price of the security. Pet. 11. That notion substitutes the materiality inquiry with a bright-line rule and is inconsistent with *Matrixx*.

Matrixx confirmed that the securities fraud element of materiality "is satisfied when there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix

of information made available." 131 S. Ct. at 1318 (internal quotation marks omitted). This Court rejected the defendant company's request that it "adopt a bright-line rule" excusing pharmaceutical companies from disclosing adverse event data until the data "establish[es] a statistically significant risk that the product is in fact causing the events." *Id.* at 1318-19. The proposed "categorical rule would artificially exclude information that would otherwise be considered significant to the trading decision of a reasonable investor." *Id.* at 1319 (internal quotation marks and alteration omitted).

Amgen's "price impact" test is, in effect, a "bright-line rule" that may "artificially exclude" misrepresentations from being considered material. It replaces a materiality analysis based on whether the misrepresentation would be "significant to the trading decision of a reasonable investor" (*id.*) with a metric—demonstrating whether a defendant's stock price increased by a statistically significant margin following a misrepresentation. Certiorari review is not warranted until other circuits fully consider and explore whether the materiality inquiry should be reduced to such a determination.

B. There Is No Clear Split Among The Circuits

There is no meaningful circuit split on the question that was decided below: whether a district court must make a determination on materiality, as defined by *Basic*, before certifying a fraud-on-the-market securities class action. On this specific question, the supposedly "irreconcilable, mature circuit split" (Pet. 8) pressed by Amgen is at best a shallow one premised on *dicta* and a misreading of opinions.

1. *Oscar* Has Been Abrogated By This Court

Oscar held that a securities fraud class-action plaintiff invoking the fraud-on-the-market presumption must prove loss causation to obtain class certification. As discussed above, *Erica P. John Fund* expressly abrogated that holding. 131 S. Ct. at 2179. *Oscar* therefore is no longer good law in the Fifth Circuit, and thus provides no basis for Amgen's assertion of a conflict with the decision below.

Amgen uses a misleadingly truncated quotation from *Oscar* to assert that some portion of the decision remains viable after *Erica P. John Fund*. According to Amgen, plaintiffs are required "to offer 'proof of a *material* misstatement . . . in order to trigger the fraud-on-the-market presumption.'" Pet. 10 (quoting *Oscar*, 487 F.3d at 265) (emphasis added by Amgen). What the Fifth Circuit actually held, however, was the following: "We now require more than proof of a material misstatement; we require proof that the misstatement *actually moved* the market. . . . Essentially, we require plaintiffs to establish loss causation." *Oscar*, 487 F.3d at 265. As this fuller quotation makes clear, *Oscar* was focused on the separate securities fraud element of loss causation, which in the court's view needed to be demonstrated at the class-certification stage with evidence of an impact on stock price. That holding is precisely what *Erica P. John Fund* abrogated.

Moreover, the aspect of *Oscar* that Amgen contends survives *Erica P. John Fund* would be no more than *dicta* in any event. Materiality, as defined by *Basic*, was never disputed by the parties in *Oscar*. *See Oscar Private Equity Invs. v. Holland*, No.

Civ. 3:03-CV-2761H, 2005 WL 877936, at *8 (N.D. Tex. Apr. 15, 2005), *vacated sub nom. Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007). *See also* Brief for Appellants, *Oscar*, *supra* (No. 05-10791), 2006 WL 5428292 (grounds for appeal were plaintiff's failure to show price impact and loss causation). Unlike the decision below, the Fifth Circuit's passing reference in *Oscar* to a "material" misstatement was not the product of careful consideration after full briefing.

Moreover, *Oscar*'s *dicta* are at odds with pre-existing Fifth Circuit law explicitly holding that the fraud-on-the-market theory *does not* relate to materiality. *See Greenberg v. Crossroads Sys., Inc.*, 364 F.3d 657, 664 (5th Cir. 2004) ("The fraud-on-the-market presumption addresses reliance, *not materiality, and the two elements are fundamentally different.*") (emphasis added). *See also Nathenson v. Zonagen Inc.*, 267 F.3d 400, 415 (5th Cir. 2001) ("[T]he complained of misrepresentation or omission [must] have actually affected the market price of the stock, [and] we conclude that it is more appropriate in such cases to relate this requirement to reliance *rather than to materiality.*") (emphasis added).

In sum, *Oscar* provides no support for the Petition because it is no longer good law. And contrary to Amgen's assertion, *Oscar* never squarely held that, in a securities fraud class action in which the plaintiff invokes the fraud-on-the-market presumption, the Rule 23(b)(3) predominance inquiry requires proof of or permits rebuttal on the element of materiality.

2. *DVI* Supports The Decision Below

The Third Circuit's decision in *DVI* does not warrant certiorari because it supports the decision below. To the extent Amgen argues otherwise, it mischaracterizes the Third Circuit's opinion.

Amgen concedes that, in the Third Circuit, "plaintiffs need not demonstrate materiality as part of an initial showing before class certification." Pet. 11 (citing *DVI*, 639 F.3d at 631). The decision below agreed with that holding. App. 2a. Thus, there is no split between the Ninth and Third Circuits on the first question presented by the Petition—namely, whether a plaintiff must establish materiality at the class-certification stage.

Amgen's argument that *DVI* creates a circuit split on the Petition's second question presented rests on a mischaracterization of the Third Circuit's decision. Amgen quotes *DVI* as holding that "[o]ne way that a defendant can rebut the presumption of reliance is by showing that 'the misrepresentations were immaterial.'" Pet. 11 (quoting *DVI*, 639 F.3d at 637). That language, however, was taken from an introductory paragraph in the *DVI* opinion summarizing *Basic*'s guidance on rebuttal generally; that passage was not describing requirements for class certification. *See* 639 F.3d at 637 (providing the "non-exhaustive list of ways that defendants can rebut the presumption" set forth in *Basic*). The *DVI* court *never* held that this statement applies in the class-certification context.

In fact, later portions of the opinion undercut Amgen's characterization of *DVI*. *DVI* held that "rebuttal *of the presumption of reliance* falls within the ambit of issues that, if relevant, should be addressed by district courts at the class certification stage."

Id. at 638 (emphasis added). The court went on to state that evidence that an allegedly false statement "did not affect the market price" of the stock may be relevant to rebut that presumption because the lack of price impact "may undercut the general claim of market efficiency or demonstrate market inefficiency relating to the securities in issue." *Id.*

That holding did *not*, however, license a free-wheeling inquiry into the *materiality* of every alleged misstatement at the class-certification stage. Lack of price impact may be one indication of lack of materiality, but lack of price impact may result from other factors unrelated to materiality: a lack of price impact is not dispositive on the question of materiality, which requires a far broader inquiry. *See infra* pp. 24-25.

Materiality was not in dispute in *DVI*, and the district court did not consider the question whether materiality could be rebutted at the class-certification stage. *See In re DVI Inc. Sec. Litig.*, 249 F.R.D. 196, 207-08 (E.D. Pa. 2008), *aff'd*, 639 F.3d 623 (3d Cir. 2011). Likewise, the Third Circuit in *DVI* held *only* that evidence of lack of price impact is relevant rebuttal at the class-certification stage, because it may disprove the existence of an efficient market in the security in question.[9] It nowhere held (or had any occasion to hold) that the materiality of each alleged false statement should be the subject of rebuttal at the class-certification stage.[10] *DVI*

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[9] Amgen never sought to present rebuttal evidence on the issue of price impact in the district court. *See infra* pp. 26-29.

[10] The *DVI* opinion as a whole makes clear that the only relevant rebuttal at the class-certification stage is rebuttal of the presumption of reliance created by the efficient capital markets hypothesis. While *DVI* does note in passing that mate-

thus does not create a circuit conflict even on the Petition's second question presented.

3. *Salomon* Does Not Create A Circuit Split Warranting This Court's Review

This leaves as Amgen's only remaining support for alleged circuit conflict the Second Circuit's decision in *Salomon*. Like *DVI*, *Salomon* addressed the relevance of evidence of price impact, as distinct from materiality, at the class-certification stage. The *Salomon* defendants' primary argument against applying the fraud-on-the-market presumption, setting aside the question of its applicability to suits against research analysts, was that the plaintiffs had not made an adequate showing of "market price effect." Brief of Defendants-Appellants at 4, *Salomon*, *supra* (No. 06-3225-cv) ("*Salomon* Appellants Br."), 2007 WL 6196992. The court rejected this argument but held that the defendants should have the opportunity to rebut the presumption of reliance by showing the absence of a price impact. *See Salomon*, 544 F.3d at 485-86.[11] The court did not state that the defendants would be permitted the opportunity to rebut materiality.

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riality is a "distinct basis for rebuttal" where a corrective disclosure does not result in a drop in stock price (639 F.3d at 638), it cites only to decisions on pleadings motions for support. Moreover, the passage describes a fact pattern not relevant here; in the district court, Amgen disputed the *reasons why* stock drops occurred (a loss-causation analysis now prohibited by *Erica P. John Fund*), but it *did not* argue that there were no impacts to Amgen's stock price on alleged corrective disclosure dates.

[11] The Second Circuit also held that the defendants should have the opportunity to rebut the presumption by showing that other market commentary had been responsible for the price impact or that particular plaintiffs had not relied on the market price. *See Salomon*, 544 F.3d at 485.

Salomon also does not support certiorari because its discussion of materiality at the class-certification stage was *dicta*. Unlike here, in *Salomon* there was no serious dispute that the alleged misrepresentations were material. *See In re Salomon Analyst Metromedia*, 236 F.R.D. 208, 222-23 (S.D.N.Y. 2006), *vacated and remanded*, 544 F.3d 474 (2d Cir. 2008). Based on a very cursory analysis of this undisputed issue, the district court found that the *Basic* standard of materiality was satisfied. *Id.* On appeal, the defendants did not challenge the district court's ruling on this point, and the issue of whether a showing of materiality was required was not, in fact, briefed. *See Salomon* Appellants Br.

For this reason, when the Second Circuit stated that plaintiffs must make a showing of materiality at the class-certification stage, *see Salomon*, 544 F.3d at 486 n.9, that issue had not been presented to that court, nor was deciding it necessary to the ultimate resolution of the issues properly on appeal. Accordingly, this statement is *dictum* that will not bind the Second Circuit in future cases and thus does not warrant this Court's review. *See United States v. Garcia*, 413 F.3d 201, 232 n.2 (2d Cir. 2005) (Calabresi, J., concurring) ("Holdings—what is necessary to a decision—are binding. Dicta—no matter how strong or how characterized—are not.").

Indeed, the issue was so little examined that the Second Circuit did not provide any guidance on how courts should make a materiality determination, a deeply fact-intensive inquiry that is generally a question for the jury. *See Press v. Chemical Inv. Servs. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999). Thus, a close examination of relevant circuit court authority fails to show an irreconcilable conflict on the need for a

plaintiff to demonstrate materiality on a class-certification motion.

The mere fact that different circuit courts have made inconsistent statements in *dicta* does not mean that this Court "'must act to eradicate disuniformity as soon as it appears.'" *California v. Carney*, 471 U.S. 386, 401 n.11 (1985) (quoting Samuel Estreicher, *A Managerial Theory of the Supreme Court's Responsibilities: An Empirical Study*, 59 N.Y.U. L. Rev. 681, 716 (1984)). Here, certiorari is not warranted because there is, at most, some conflicting *dicta* from other circuits; there is no well-established split on either question presented.

4. Amgen's Contention That It May "Disprove Materiality" On Rebuttal Confuses Materiality With "Price Impact"

Amgen's argument that there is a circuit split repeatedly conflates the concepts of materiality and price impact. For example, Amgen has not simply argued that it was wrongly denied the opportunity to "rebut the applicability of the fraud-on-the-market theory by disproving the materiality of the alleged misrepresentation." Pet. 11. Amgen also has specifically stated that its method of "disproving materiality" is with evidence "showing that the market already was 'privy to the truth,' and accordingly *that no alleged misrepresentation had any impact on the price of Amgen stock*." Pet. 5 (emphasis added) (citing *Basic*, 485 U.S. at 248). Amgen thus equates a lack of price impact with a lack of materiality. But, as the Second Circuit acknowledged in *Salomon*, it is "a misreading of *Basic*" to "argue that the concept of materiality in *Basic* . . . refers to a material [e]ffect

on market price." 544 F.3d at 482 (internal quotation marks omitted). *See also In re SLM Corp. Sec. Litig.*, No. 08 Civ. 1029 (WHP), 2012 WL 209095, at *5 (S.D.N.Y. Jan. 24, 2012) ("A legal assessment of materiality is . . . not determined by a single factor such as price impact, but must take into account all the relevant circumstances in a particular case.") (citing *Matrixx*, 131 S. Ct. at 1317).[12]

C. There Is No Need For This Court To Rush To Grant Review

Amgen asserts that this Court should grant certiorari because "the likelihood that the issues will be presented again in a discretionary Rule 23(f) appeal is necessarily low." Pet. 18.[13] However, there is strong evidence to the contrary.

Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., 597 F.3d 330 (5th Cir. 2010), is the Fifth Circuit decision applying *Oscar*'s loss-causation standard that was subsequently vacated by this Court in *Erica P. John Fund*. On remand, the district court granted the plaintiff's motion to certify the class. *See Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, No. 3:02-CV-1152-M, 2012 WL 565997, at *1 (N.D. Tex. Jan. 27, 2012).

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[12] Amgen did not preserve the issue of price impact below and therefore has waived it as an issue in this Court. As a result, its assertion of a circuit split regarding the question of price impact at the class-certification stage is academic, because this is not a suitable case in which to address it. *See infra* p. 28.

[13] Amgen's assertion about the bleak prospects of future Rule 23(f) appeals is a complete about-face from what it said to the Ninth Circuit: "[a] *growing* number of circuit courts have *begun* to address this issue through Rule 23(f) review." Petition for Permission To Appeal at 1, No. 09-80141 (filed Aug. 28, 2009) (emphases added).

That ruling is currently the subject of a pending Rule 23(f) petition in which the viability of price impact rebuttal evidence is at issue. The defendants assert that the district court improperly failed to consider their fraud-on-the-market rebuttal evidence establishing "that the alleged misrepresentations did not distort the market price" of defendant Halliburton's stock. Defendants' Petition for Permission to Appeal the District Court's January 27, 2012 Order Granting Plaintiff's Motion To Certify Class at 1, *Erica P. John Fund, Inc. v. Halliburton Co.*, No. 12-90007 (5th Cir. filed Feb. 10, 2012), 2012 WL 560072. Notwithstanding Amgen's contention that the purported conflict is "entrenched" (Pet. 13), this example illustrates that Rule 23(f) appeals are pending and do arise regarding the appropriateness of "price impact" evidence at the class-certification stage.[14] Accordingly, as with the materiality discussion in Part I.A, above, in light of this Court's recent decisions, any split in authority that arguably might exist on the issue of "price impact" is not mature, irreconcilable, or entrenched.

II. The Petition Presents A Poor Vehicle For Certiorari Review

This case presents a poor vehicle for reviewing the questions presented because Amgen failed to

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[14] Even if the Fifth Circuit declines to hear the pending petition, there are likely to be others. In abrogating the Fifth Circuit's holding in *Oscar*, this Court noted that *Oscar* "include[d] some language consistent with a 'price impact' approach." *Erica P. John Fund*, 131 S. Ct. at 2187. Whether or how the Fifth Circuit will permit rebuttal at the class-certification stage based on price impact evidence are questions that losing litigants will be motivated to have that court answer via the Rule 23(f) appeal process.

satisfy the very evidentiary standard it seeks to have this Court adopt. Amgen contends that it "sought affirmatively to rebut" the presumption of reliance that Connecticut invoked in moving for class certification "by showing that the market already was privy to the truth, and accordingly that no alleged misrepresentation had any impact on the price of Amgen stock." Pet. 5 (internal quotation marks omitted). But Amgen's evidentiary showings fell far short of sustaining that burden. Thus, this Court's resolution of the questions presented would not affect the correctness of the judgment below, making this case a poor candidate for this Court's review.

Despite its effort to invoke *Salomon* and *DVI*, Amgen in fact presented *no* evidence "showing that [the] market price [of Amgen's stock] was not affected" by its alleged misrepresentations. *Salomon*, 544 F.3d at 485; *see also DVI*, 639 F.3d at 638 (stating that defendant must show that misleading material statements or corrective disclosures "*did not affect the market price of the security* [to] defeat[] the presumption of reliance for the entire class").

On two issues alone—the safety of Amgen's ESAs and their growth potential—Connecticut alleges that Amgen made false and misleading statements on a dozen dates in 2004, 2005, 2006, and each of the first five months of 2007. R133-40 V.2 Tab 6. Amgen did not file an expert report, conduct an event study, or otherwise attempt empirically to analyze Amgen's stock price movement (or the lack thereof) on or immediately after any of these dates. Of the 81 "publicly available" exhibits in its RJN, only *one* was explicitly identified as relating to Amgen's stock price, and that one exhibit included only information relating to the close of the class period: "the closing

stock price for Amgen . . . on May 9, 2007, and Amgen's intraday stock prices for May 10, 2007." R1574 V.8 Tab 23.[15]

In sum, Amgen presented no evidence to support the "price impact" test articulated in *Salomon* and *DVI*. Nor did it raise the issue of price impact below, and the Ninth Circuit never decided whether rebuttal evidence on price impact is permitted at the class-certification stage. Not only did Amgen fail to raise this issue below, it affirmatively argued that once a plaintiff establishes materiality it may be "*presume[d]* [that] a misrepresentation or omission affected a security's market price." Pet'rs C.A. Br. 20 (emphasis added). Accordingly, Amgen has waived its right to argue that plaintiffs must show price impact to trigger the presumption of reliance or that defendants must be permitted to rebut the presumption by showing the absence of price impact. This issue is therefore not properly before this Court. *See EEOC v. FLRA*, 476 U.S. 19, 24 (1986) (stating that this Court will "refrain from addressing issues not raised in the Court of Appeals").

Indeed, Amgen's own *amici* recognize that Amgen failed to link its truth-on-the-market assertions with any impact (or demonstrable lack of impact) on Amgen's stock price: "Petitioners here introduced rebuttal evidence that the alleged misrepresentations were immaterial because the truth was already known to the market and therefore *presumably* was already incorporated into the market price." Brief of

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[15] On the quoted page, Amgen misidentifies the chart as Exhibit 78; elsewhere in the document it is correctly identified as Exhibit 79. The chart itself may be found at R2450 V.11 Tab 103.

Amici Curiae Chamber of Commerce and PhRMA Supporting Petitioners at 8 ("Chamber/PhRMA Brief") (emphasis added). But the cases on which Amgen relies do not create a legal *presumption* of a lack of price impact; the evidence must *show* a lack of price impact to succeed.

Amgen's complete failure to introduce "price impact" evidence is directly at odds with the evidentiary burden it asks this Court to address. Accordingly, the Petition presents a poor vehicle for certiorari review.

III. Amgen Overstates The Importance Of This Case

At its core, the Petition does not present a coherent legal argument for why *Basic*'s presumption of reliance requires a threshold showing of materiality at the class-certification stage. As the court below held, adopting the persuasive reasoning of Judge Easterbrook's opinion in *Schleicher*, once the market in a given security is shown to be efficient, the question of the materiality of a public statement affects all class members similarly. *See supra* pp. 12-15.

Instead of a coherent legal argument, the Petition advances naked public policy arguments about the perceived unfairness of securities fraud defendants having to face the prospect of defending against claims brought by a certified class. These blunderbuss arguments are not, without more, sufficient reason for this Court to grant certiorari where there is no well-established circuit split, and where this Court last Term issued three important decisions that will significantly affect the development of the law.

Moreover, many of the policy arguments by Amgen and its *amici* are demonstrably flawed. For instance, the Chamber/PhRMA Brief (at 16) notes that, in the "era" before the Fifth (2007), Second (2008), and Third (2011) Circuits imposed their versions of the price impact test, "at least 94% of 10b-5 class certification motions were granted." That statistic is originally from a 1996 law review article using data from four district courts for a two-year period prior to the implementation of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). *See* Thomas E. Willging et al., *An Empirical Analysis of Rule 23 to Address the Rulemaking Challenges*, 71 N.Y.U. L. Rev. 74, 82 (1996). Post-PSLRA data, in contrast, confirm that, to a great degree, securities class-action defendants already can and do employ the pre-trial procedural devices designed to address merits issues.

Based on data from 1996-2011, 57% of securities class actions do not make it past the first ruling on a motion to dismiss.[16] Of those that do, 18.6% reach a ruling on summary judgment.[17] The Chamber/PhRMA Brief contends (at 17) that only 8% of securities class actions reach a ruling on summary judgment, but this is highly misleading because it includes in its denominator the 57% of cases that are dismissed at the first challenge on the pleadings, rather than the remaining 43% of actions that survive the first ruling on a motion to dismiss. What

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[16] Stanford Law School Securities Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings: 2011 Year in Review* 18 (2012) ("2011 Stanford"), *available at* http://securities.stanford.edu/clearinghouse_research/2011_YIR/Cornerstone_Research_Filings_2011_YIR.pdf.

[17] *Id.*

these statistics show is that securities class-action defendants already have numerous opportunities, prior to trial, to challenge materiality or other merits questions "capable of classwide resolution." *Dukes*, 131 S. Ct. at 2551.

Moreover, Amgen's position threatens to disrupt the effective administration of class actions across the country. Were the nature of the certification determination judicially changed in the manner that Amgen suggests so that it could routinely involve the equivalent of Rule 56 determinations, the timing of the certification decision would need to be routinely deferred until after full merits discovery. The result, for practical purposes, would be the elimination of the distinction between Rule 56 and Rule 23 determinations, with a consequent diminution in the number of case management tools available to the district court.

Finally, on the issue of forum shopping, *amici*'s assertions are greatly overblown. The Second Circuit's *Salomon* decision was issued on September 30, 2008. From 1997-2008, on average, 23.9% of securities class actions were filed in the Second Circuit.[18] From 2009-2011, the so-called *Salomon* "era," the Second Circuit's share of filings *increased* to a range of between 25.6% and 34.7%.[19] The exodus to other jurisdictions envisioned by *amici* (*see* Brief of *Amici Curiae* Former SEC Commissioners and Officials and

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[18] Stanford Law School Securities Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings – 2009: A Year in Review* 25 (2010), *available at* http://securities.stanford.edu/clearinghouse_research/2009_YIR/Cornerstone_Research_Filings_2009_YIR.pdf.

[19] 2011 Stanford at 26.

Law and Finance Professors at 9-11) is simply not borne out by the facts. As with the other arguments of Amgen's *amici*, the data do not support granting certiorari in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

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REPLY BRIEF

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BRIEFS

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IN THE

Supreme Court of the United States

AMGEN INC., KEVIN W. SHARER, RICHARD D. NANULA, ROGER M. PERLMUTTER, GEORGE J. MORROW,
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

Respondent's opposition rests largely on denying an acknowledged, deep, mature, and important circuit split. The circuits in conflict account for approximately three-fourths of all securities fraud class-action filings, and their conflicting holdings require district courts to apply different class-certification standards depending on where a case is filed. The conflict is squarely presented in this case; it will not be resolved by recent decisions of this Court; and since none of the circuits is likely to grant a further petition under Rule 23(f) on the questions presented here, the chance to resolve the conflict may not recur. The Court should grant the petition and reverse.

I. RESPONDENT MISCHARACTERIZES THE PETITION

Many of respondent's arguments rest on the assertion that Amgen seeks review of a "bright-line rule requiring proof of 'price impact.'" Opp. i-ii. That assertion is incorrect. The first question presented is whether "the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory." Pet. i. The question does not refer to "price impact," and the petition does not argue that proof of price impact is the only way to show materiality. The second question presented is whether a district court, before certifying a class, must allow a defendant to rebut the applicability of the fraud-on-the-market theory in the manner described by this Court in *Basic Inc.* v. *Levinson*, 485 U.S. 224, 248 (1988). Here, the lower courts barred Amgen from rebutting the theory with evidence showing that, because the market was "privy to the truth," the alleged misrepresentations were not material. *Id.*

Amgen's position was and is that a plaintiff must prove materiality, in any manner, and that a defendant's showing that the market was already "privy to the truth" would defeat materiality. Amgen's position flows directly from *Basic*, which recognized that if a defendant can show that the market is "privy to the truth," then "the basis for finding that the fraud had been transmitted through market price would be gone." 485 U.S. at 248. The point is that by disproving materiality a defendant indirectly shows lack of price impact and defeats the fraud-on-the-market theory, but neither *Basic* nor the petition suggest that "quantitative evidence" of price impact (Opp. i) is required.

II. THE NINTH CIRCUIT'S DECISION DEEPENS A MATURE CIRCUIT SPLIT

A. The Circuit Split Is Real And Acknowledged By The Courts Of Appeals

The Ninth Circuit understood that it was deepening a serious split between the courts of appeals, acknowledging the split (App. 9a-11a) and explicitly rejecting the holdings of those "circuits that require a plaintiff to prove materiality at the class certification stage." App. 10a. The Seventh Circuit also understood that its decision conflicted with the holdings of other courts of appeals that "materiality [is] a condition to class certification." *Schleicher* v. *Wendt*, 618 F.3d 679, 687 (7th Cir. 2010). Though respondent defends the decision below, it disagrees with the Ninth Circuit's (and Seventh Circuit's) view of the law, contending that this acknowledged split is "illusory." Opp. 12. Respondent bases this statement on two assertions, neither of which is correct: (1) that the Second, Third, and Fifth Circuit's statements on the questions presented are dicta, and (2) that the decisions of those courts relate not to materiality, but only to "price impact." Opp. 18, 20-24.

1. The text of the Second Circuit's decision directly refutes respondent's first assertion: "[W]e *hold* that plaintiffs must show that the statement is material (a prima facie showing will not suffice)." *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 486 n.9 (2d Cir. 2008) (emphasis added). The Second Circuit's holding on the point was essential to the court's judgment. *See Seminole Tribe of Florida* v. *Florida*, 517 U.S. 44, 66-67 (1996) (court's holding includes the "rationale upon which [it] based the result[]"). The holding provided the basis for the court's ruling that the plaintiffs had adequately shown materiality at class certification,

even though they had not sought to prove price impact independently from their proof of the fraud-on-the-market predicates. 544 F.3d at 483-485. The Second Circuit explained: "The point of *Basic* is that an effect on market price is *presumed* based on the materiality of the information and a well-developed market's ability to readily incorporate that information into the price of securities." *Id.* at 483. There is no doubt that district courts in the Second Circuit now must require plaintiffs to prove materiality at the class-certification stage.

The Second Circuit's ruling on the rebuttal issue—that "the [district] court must permit defendants to present their rebuttal arguments 'before certifying a class'"—was also undisputedly a holding. 544 F.3d at 485 (citation omitted). Indeed, it was the basis for the remand. *See id.* at 486 ("We thus vacate the order certifying the class and remand to allow the district court to permit defendants the opportunity to rebut the *Basic* presumption prior to class certification."). The Second Circuit did not, as respondent alleges (Opp. 22), confine rebuttal to proof of price impact. Instead, the court listed price impact as an example, while also recognizing that defendants could "rebut proof of the elements giving rise to the [fraud-on-the-market] presumption." 544 F.3d at 483. Relying on *Basic*, the Second Circuit stated that rebuttal could occur through "*[a]ny showing* that *severs the link* between the alleged misrepresentation and ... the price." *Id.* at 484 (quoting *Basic*, 485 U.S. at 248) (first emphasis added).

2. Respondent's assertions (Opp. 20-22) about the Third Circuit's decision in *In re DVI, Inc. Securities Litigation*, 639 F.3d 623 (3d Cir. 2011), are also contradicted by the opinion's text. The Third Circuit held that "rebuttal of the presumption of reliance falls within the ambit of issues that, if relevant, should be ad-

dressed by district courts at the class certification stage." *Id.* at 638. The court did not limit rebuttal to proof of an absence of price impact. To the contrary, the Third Circuit explicitly identified immateriality as "a distinct basis for rebuttal." *Id.*; *see also id.* at 637 (providing "non-exhaustive list of ways that defendants can rebut the presumption, including by showing ... the misrepresentations were immaterial"). To the extent the Third Circuit identified proof of absence of price impact as one basis for rebuttal, the court grounded its conclusion on the explanation that such proof "serve[s] as a rebuttal ... *because* it renders the misstatement *immaterial*." *Id.* at 638 (emphases added).

3. Finally, respondent wrongly characterizes (Opp. 18-19) as dictum the Fifth Circuit's requirement of "proof of a material misstatement" as a precondition to certifying a class based on the fraud-on-the-market theory. *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261, 265 (5th Cir. 2007), *abrogated on other grounds by Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179 (2011). The Fifth Circuit has consistently included materiality in the list of elements plaintiffs must prove to invoke the fraud-on-the-market theory.[1] The court has also explained that its precedent "*mandates* 'a complete analysis of fraud-on-the-market indicators' at the class certification stage, insisting that district courts 'find' the facts favoring class certification." *Oscar*, 487 F.3d at 268-269 (emphasis added); *see also Unger* v. *Amedisys Inc.*, 401 F.3d 316, 325 (5th Cir. 2005) (same).

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[1] *See, e.g., Fener* v. *Operating Eng'rs Const. Indus.*, 579 F.3d 401, 406-407 (5th Cir. 2009); *Alaska Elec. Pension Fund* v. *Flowserve Corp.*, 572 F.3d 221, 227-228 (5th Cir. 2009); *Oscar*, 487 F.3d at 264; *Greenberg* v. *Crossroads Sys., Inc.*, 364 F.3d 65 (5th Cir. 2004).

The Fifth Circuit's holding in *Oscar* that it "require[s] ... proof of a material misstatement" (487 F.3d at 265) was necessary to the result. Starting with (1) this holding on materiality and (2) the court's recognition that "'materiality translates into information that alters the price of the firm's stock,'" the Fifth Circuit ultimately held in *Oscar* (3) that a plaintiff must "'prove that the defendant's non-disclosure materially affected the market price of security'" through proof of "loss causation." *Id.* at 265 & n.14. This Court's decision in *Erica P. John Fund* abrogated *Oscar*'s holding only on the third point. This Court did not overrule or otherwise call into question the Fifth Circuit's holding on the first point, which is binding on district courts in that circuit. *See* 131 S. Ct. at 2187.[2]

B. The Circuit Split Is Mature And Firm, And Will Not Benefit From (Or Likely Receive) Further "Percolation"

The split involves circuits in which approximately three-fourths of all securities class actions are filed, the issues have been fully considered in circuit court opinions, and there is no sign that any of the courts will *sua sponte* reverse itself. There is accordingly no need for, or likely prospect of, further percolation.

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[2] The passages respondents quote (Opp. 19) from *Greenberg*, 364 F.3d at 664, and *Nathenson* v. *Zonagen Inc.*, 267 F.3d 400, 415 (5th Cir. 2001), are inapposite, as each merely states the undisputed proposition that the fraud-on-the-market theory is a means of satisfying the reliance element, rather than the materiality element, of a Rule 10b-5 claim. These passages do not concern the distinct proposition, recognized in other parts of both opinions, that materiality is a necessary predicate for invoking the fraud-on-the-market theory. *Greenberg*, 364 F.3d at 661; *Nathenson*, 267 F.3d at 413.

1. Contrary to respondent's argument (Opp. 12-16), this Court's decisions in *Erica P. John Fund* and *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541 (2011), do not render the split any less mature or offer any reasons to believe that the courts of appeals will reconsider their decisions or resolve the split on their own. *Erica P. John Fund* is explicit that, apart from the loss-causation issue considered there, this Court did not "address any other question about *Basic*, its presumption, or how and when it may be rebutted." 131 S. Ct. at 2187.

Dukes is relevant in that it *raised* the bar for class certification, confirming that district courts must conduct a "rigorous analysis" under Rule 23 and holding that "[a] party seeking class certification must affirmatively demonstrate his compliance with the Rule—that is, he must be prepared to prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc." 131 S. Ct. at 2551. This Court specifically admonished lower courts that had "mistakenly" read precedent to foreclose inquiry into merits issues at the class-certification stage. *Id.* at 2552 n.6. *Dukes* thus indicates that district courts should conduct a *more* rigorous analysis of the predicates to the fraud-on-the-market theory, regardless of whether that analysis overlaps with merits issues to be addressed at summary judgment or trial. *See generally* Pet. 24-26.

The Ninth Circuit considered *Dukes*, but mistakenly joined the Seventh Circuit in requiring a *less* rigorous analysis of the predicates to the fraud-on-the-market theory at the class-certification stage. Having made its decision with the benefit of both *Dukes* and *Erica P. John Fund*, and having denied Amgen's petition for rehearing *en banc*, the Ninth Circuit has no reason to reconsider and *sua sponte* reverse itself.

Neither *Dukes* nor *Erica P. John Fund* provides any reason to expect the Second, Third, and Fifth Circuits to revisit their holdings. To the contrary, as explained in Amgen's petition (Pet. 21-26), this Court's decisions support the Second and Fifth Circuits, and support the Third Circuit's position regarding rebuttal of the fraud-on-the-market theory. In sum, the courts of appeals are at an impasse that only review by this Court can resolve.[3]

2. It is unlikely that another opportunity will arise for this Court to review the questions presented. Circuits accounting for the substantial majority of securities litigation have resolved the issues, albeit differently, and are unlikely to grant Rule 23(f) discretionary appeals in cases raising the issues here so long as the district courts adhere to circuit precedent. Respondent's only quibble on this point (Opp. 26) is a factual one—namely, that on remand in *Erica P. John Fund* the district court granted class certification and the defendant is seeking leave to appeal under Rule 23(f). The Fifth Circuit has not granted the petition, however, and in any event Amgen's point is not that it is impossible for the questions presented to arise in those circuits but only that the chances are very low, given the circuits' rules governing Rule 23(f) appeals. *See* Pet. 18 & n.7.

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[3] Respondent's assertion (Opp. 16-17) that *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309 (2011), will cause further review of the questions presented in the lower courts turns on respondent's mischaracterization of Amgen's petition as proposing a bright-line, price-impact rule and, for that reason, has no merit.

III. This Case Presents A Good Vehicle For Review Of The Questions Presented

1. This case cleanly presents both questions on which Amgen seeks review. Amgen argued in the district court and Ninth Circuit that respondent needed to prove materiality for a class to be certified based on the fraud-on-the-market theory and that Amgen should be allowed to rebut any such showing. Both the district court and Ninth Circuit addressed Amgen's contentions by squarely holding, as a matter of law, that respondent did not need to prove materiality and that Amgen was not entitled to rebuttal on the issue. *See* App. 8a-13a (court of appeals); App. 32a-38a, 40a-44a (district court).

Respondent asserts that Amgen "changed course" between the district court and the Ninth Circuit, raising materiality for the first time at the court of appeals. Opp. 8-9. The assertion is just not correct, as even a cursory review of Amgen's briefs and the lower court's decision show. *See* App. 32a-34a, 40a-41a (district court's description of Amgen's arguments); Dkt. 198, Pet. Mem. Opposing Class Cert. 20-23, 25. Indeed, the assertion is refuted by respondent's own description of Amgen's district court position:

> [Amgen] argued that Plaintiff must also prove each of the other facts required to establish the applicability of the presumption, including, among others, the *materiality* and falsity of the alleged misstatements and omissions ... , plus loss causation ... , and that, in any event, [Amgen] should have an opportunity to rebut the applicability of the presumption with a truth-on-the-market defense against the allegation of materiality.

Resp. C.A. Br. 7-8 (emphasis added). Respondent's contention here (Opp. 7-9) that Amgen opposed class certification only on loss-causation grounds is incorrect.

2. Respondent's only other "vehicle" argument is the observation that "Amgen presented no evidence to support the 'price impact' test" that respondent says Amgen proposes. Opp. 26-29. As explained (*supra* p. 2), however, respondent's characterization of Amgen's position is wrong. This case presents a strong vehicle for review of the questions that Amgen's petition does present and that Amgen did litigate below: whether respondent needed to prove materiality for a class to be certified based on the fraud-on-the-market theory, and whether Amgen should have been allowed to rebut any such showing.

IV. THE NINTH CIRCUIT'S DECISION IS WRONG

Respondent largely ignores whether the Ninth Circuit decision is correct. *See* Opp. 12-32. It is not: the petition explains why the fundamental logic of *Basic* requires that district courts demand proof of the materiality predicate before class certification. *See* Pet. 19-24. The petition also explains why there is no logical basis for the Ninth Circuit's separation of materiality, alone among all the predicates to the fraud-on-the-market theory, for different treatment at the class-certification stage. *See* Pet. 24-28. Respondent has no answer.

Respondent's only defense of the Ninth Circuit is the contention that the court correctly applied *Dukes*. *See* Opp. 12-16. In making this argument, however, respondent again ignores Amgen's several reasons (Pet. 24-26) why *Dukes* proves the opposite. And the argument respondent does make—that *Dukes* purportedly shows that the materiality predicate is irrelevant to class certification—is flawed.

There is no dispute that, like market efficiency, materiality is a predicate to the fraud-on-the-market theory. *See* Pet. 20-21. There is also no dispute that absent the fraud-on-the-market theory, individual issues would predominate in purported class actions for securities fraud because of the need to prove individual reliance. *See* Pet. 2. Respondent's argument (Opp. 14)—like the Ninth Circuit's (App. 8a-9a)—is that inquiry into the materiality predicate nevertheless should be deferred because, if a plaintiff were unable to prove materiality as an element of the claim, then every class member would lose on the merits, leaving no individual issues for litigation. But this argument confuses the question. A Rule 23 determination must be made before and independently of any merits determination. And Rule 23 provides no exception for subjects that, if litigated at class certification, might reveal that the plaintiff's and class's claims lack merit. Indeed, that is the very point of *Dukes*. *See* 131 S. Ct. at 2551-2552.

This principle is especially relevant here, where the reason for the Rule 23 inquiry into materiality is distinct from the reason for the merits inquiry into the same issue. Rule 23 requires courts to examine materiality as a predicate to the fraud-on-the-market theory because only application of that theory allows for classwide proof on the reliance element. That a plaintiff's failure to prove the *materiality predicate* might have ramifications for the case's merits on the *materiality element*—even as to all class members—is irrelevant to whether individualized issues predominate on the *reliance element*.

This Court and the courts of appeals agree that the efficient-market and public-statement predicates must be proven at class certification. The materiality predi-

cate should be treated the same. The Ninth Circuit erred in holding otherwise.

CONCLUSION

The petition for a writ of certiorari should be granted.

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CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICI CURIAE* CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND PHARMACEUTICAL RESEARCH AND MANUFACTURERS OF AMERICA SUPPORTING PETITIONERS

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QUESTIONS PRESENTED

1. Whether, in a misrepresentation case under SEC Rule 10b-5, the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory.

2. Whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

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IN THE

Supreme Court of the United States

No. 11-1085

AMGEN INC., ET AL.,

Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICI CURIAE* CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND PHARMACEUTICAL RESEARCH AND MANUFACTURERS OF AMERICA SUPPORTING PETITIONERS

INTEREST OF *AMICI CURIAE*[1]

The *amici curiae* are the Chamber of Commerce of the United States of America (the "Chamber"), and the Pharmaceutical Research and Manufacturers of America ("PhRMA"). Each has a significant interest in the interpretation and enforcement of the federal securities laws

[1] No counsel for a party authored this brief in whole or in part. No person or entity other than *amici*, their members, or their counsel made a monetary contribution intended to fund the preparation or submission of this brief. Counsel of record provided timely notice of of *amici*'s intent to file this brief. Consent letters have been filed with the Clerk concurrently with this brief.

and the rules governing class actions in private securities cases.

The Chamber is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of three million companies and professional organizations of every size, in every industry sector, and from every region of the country. Chamber members transact business throughout the United States and a large number of countries around the world. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. The Chamber has participated as *amicus curiae* in various class-action appeals, including recently in this Court.

PhRMA is a voluntary, nonprofit association that represents the country's leading research-based pharmaceutical and biotechnology companies. PhRMA's members invent and develop medicines that save lives and improve the quality of life for millions of patients around the world. PhRMA's members have invested hundreds of billions of dollars in the last decade to develop new medicines—including over $45 billion in 2010 alone. PhRMA serves as the pharmaceutical industry's principal policy advocate, advancing policies that foster continued medical innovation, and has participated as *amicus curiae* in appeals involving issues of significance to the pharmaceutical industry. The issues in this case are especially significant to PhRMA members because many of them have borne the expense and burden of defending against securities-fraud class actions in recent years, which raise the already substantial cost and risks of developing new medicines.

SUMMARY OF ARGUMENT

The court of appeals' decision joins the wrong side of circuit splits on both questions presented in the petition.

The decision below also conflicts with this Court's opinions. It conflicts with both *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), and *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179 (2011), because in those cases the Court declared that the "fundamental premise" of the presumption of reliance is a misrepresentation's impact on the market price. If an alleged misrepresentation is not material, it will not move the market price of a stock that trades in an efficient market. And if the market price is not distorted, there is no basis for presuming that the entire class relied on misrepresentations by relying on a market price that reflects the misrepresentation. Individual class members will need to prove actual reliance on the misrepresentation, rendering class certification impossible.

The decision below contradicts last Term's decision in *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541 (2011), as well. *Wal-Mart* established beyond doubt that a plaintiff must prove that the Rule 23 requirements are "in fact" satisfied. In this case, as in most Rule 10b-5 cases, the lead plaintiff cannot satisfy Rule 23(b)(3)'s predominance requirement unless it can trigger and sustain the presumption of classwide reliance. The court of appeals failed to put plaintiff to its proof. It relieved the plaintiff of the duty to prove the materiality prerequisite to the presumption of reliance. And it prevented defendant from introducing relevant evidence to rebut the presumption. Thus, the court of appeals improperly allowed class certification without determining whether plaintiff can "in fact" satisfy Rule 23(b)(3). Certiorari should be granted and the judgment reversed.

ARGUMENT

Petitioners have demonstrated that the court of appeals' decision deepens a festering circuit split with respect to (1) whether Rule 10b-5 plaintiffs must prove ma-

teriality in order to use the presumption of classwide reliance and obtain class certification and (2) whether defendants are entitled to rebut the presumption of reliance at the class-certification stage. Certiorari is warranted for these reasons alone. Further review is urgently needed for at least three additional reasons: the court of appeals' decision (1) contradicts the reasoning of *Basic* and *Erica P. John Fund* that the "fundamental premise" of the fraud-on-the-market presumption is that a misrepresentation distorted the stock price, by certifying a class where that fundamental premise is absent; (2) defies this Court's recent holding in *Wal-Mart* that plaintiffs must satisfy all of the Rule 23 requirements, even if doing so requires submission of merits-related evidence; and (3) subjects defendants to immense settlement pressure in cases where defendants have not only meritorious substantive defenses, but also have evidence that defeats class certification.

I. The Court Of Appeals' Decision Is Contrary To Both *Basic* And *Erica P. John Fund*

1. As this Court recognized in *Basic Inc.* v. *Levinson*, 485 U.S. 224, 242 (1988), "[r]equiring proof of individualized reliance * * * effectively * * * prevented [securities-fraud plaintiffs] from proceeding with a class action, since individual issues * * * overwhelmed the common ones." To remedy that perceived problem, *Basic*'s four-Justice majority ruled that a putative class-action plaintiff may obtain a rebuttable presumption of classwide reliance by using the "fraud-on-the-market" theory. 485 U.S. at 245.[2]

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[2] Chief Justice Rehnquist and Justices Scalia and Kennedy did not participate. *Basic*, 485 U.S. at 250. Justice Blackmun wrote the majority opinion joined by Justices Brennan, Marshall, and Stevens. *Id.* at 226. Justices White and O'Connor dissented in relevant part. *Id.* at 250-263.

The fraud-on-the-market theory assumes that in an efficient, well-developed market, all public, material information about a company is known to the market and reflected in the company's stock price. *Id.* at 246. The theory further posits that "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of [the market] price." *Id.* at 247. Because material misrepresentations presumably distort the market price, "an investor's reliance on any public, material misrepresentations * * * may be presumed for purposes of a Rule 10b-5 action." *Ibid.*

To trigger the fraud-on-the-market presumption of reliance, the plaintiff must "plead and prove" certain "threshold facts": that (1) the defendant "made public, material misrepresentations"; (2) the defendant's shares were traded in an "efficient market"; and (3) "the plaintiff traded shares between the time the misrepresentations were made and the time the truth was revealed." *Basic*, 485 U.S. at 248 & n.27.

Even if the plaintiff establishes these threshold facts, the presumption of reliance remains "subject to rebuttal." *Basic*, 485 U.S. at 245. A defendant may rebut the presumption of reliance in multiple ways. It may "rebu[t] proof of the elements giving rise to the presumption"—for example, by showing that the statements were not material or not public, or that the market was not efficient. *Id.* at 248. Or the defendant may "show that the misrepresentation in fact did not lead to a distortion of price." *Ibid.* The Court summarized the permissible rebuttal proof in the broadest possible language: "*Any showing* that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff" will "rebut the presumption of reliance." *Ibid.* (emphasis added). Thus, where the record shows that "the market price [was] not * * * affected by [the] mis-

representations," the presumption is rebutted—the plaintiff class *cannot* have relied on misrepresentations by relying on a distorted market price where the market price was not affected. *Ibid.*

2. Under the court of appeals' holding, by contrast, the fraud-on-the-market presumption provides a free pass to class certification for any plaintiff suing a company whose stock trades in an efficient market. That approach rests on a misreading of *Basic* and this Court's recent explication of the presumption of reliance in *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179 (2011).

The *Basic* Court created the presumption of reliance for the express purpose of making class certification *possible* in Rule 10b-5 cases. But it did not make certification *automatic*, nor did it judicially repeal Rule 23(b)(3)'s predominance requirement. The Court simply held that common issues of reliance predominate if the class presumptively relied on misrepresentations by relying on a market price that has been distorted by those misrepresentations. To that end, the Court required assurances that the market price was in fact affected by the alleged misrepresentations. *Basic*, 485 U.S. at 248. That makes sense, for the entire class cannot claim to have relied on the misrepresentation by relying on the market price if "the market price [was] not * * * affected by [the] misrepresentation." *Ibid.* Without such evidence, "the causal connection" between the misrepresentation and the plaintiff's reliance "[w]ould be broken" because "the basis for finding that the fraud had been transmitted through market price would be gone." *Ibid.*

The focus on the misrepresentation's effect on market price underlies every aspect of *Basic*. To trigger the rebuttable presumption in the first instance, a plaintiff must prove certain "threshold facts," each of which is designed to ensure that the alleged misrepresentations ac-

tually affected the market price. The requirement of public misstatements ensures that the statement reached the market in the first place. The requirement of an efficient market ensures that the market price of a given stock typically incorporates available information in a timely fashion. And of particular salience here, the materiality requirement ensures that the misrepresentation is sufficiently important and relevant to affect the market price. If a plaintiff cannot make any one of these threshold showings, there is no basis for presuming that the entire class relied on the misrepresentations by relying on the market price.

Likewise, the defendant may "rebut the presumption of reliance" with "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff." *Basic*, 485 U.S. at 248. As noted, rebuttal evidence may include direct proof that the statements were immaterial or proof that they did not distort the market price (perhaps because they were immaterial or because the market was inefficient with respect to the particular misrepresentations). Evidence pertaining to materiality rests at the very heart of the presumption of reliance.

3. The court of appeals asserted that this Court did not require proof of materiality in *Basic*, claiming instead that the Court merely observed in a footnote the lower court's imposition of a materiality requirement. Pet. App. 10a-11a. That is not so. To be sure, the Court first recounted the court of appeals' holding that a plaintiff seeking to use the presumption of reliance must show, *inter alia*, that the defendant's "misrepresentations were material" and that those misrepresentations "would induce a reasonable, relying investor to misjudge the value of the shares." *Basic*, 485 U.S. at 248 n.27. But the Court then added: "Given today's discussion regarding

the definition of materiality as to preliminary merger discussions," those "[two] elements * * * may collapse into one." *Ibid.* In so doing, the Court plainly signaled its endorsement of the requirement that a plaintiff establish materiality (as defined in *Basic*) to trigger the presumption of reliance.

Throughout its opinion, moreover, the Court repeatedly emphasized that the presumption of reliance applies to "material" misstatements. *E.g.*, *Basic*, 485 U.S. at 241, 244, 245, 246, 247, 248; see also *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 341-342 (2005) (emphasis added) (referring to the "nonconclusiv[e] presum[ption] that the price of a publicly traded share reflects a *material* misrepresentation and that plaintiffs have relied upon that misrepresentation"). And for good reason: materiality is a logical prerequisite to establishing the presumption of classwide reliance. Without a material misstatement that moves the market, there is no basis for presuming that reliance on the integrity of the market price equals reliance on the alleged misrepresentation.

4. Petitioners here introduced rebuttal evidence that the alleged misrepresentations were immaterial because the truth was already known to the market and therefore presumably was already incorporated into the market price. In refusing to consider that evidence, the court of appeals not only violated the principles of *Basic* set forth above; it also ignored *Basic*'s specific endorsement of that precise type of rebuttal evidence.

As this Court held in *Basic* and reaffirmed just last Term, the "materiality requirement is satisfied when there is a substantial likelihood that the disclosure * * * would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Matrixx Initiatives, Inc.* v. *Siracusano* 131 S. Ct. 1309, 1318 (2011) (quoting *Basic*, 485 U.S. at

231-232). A statement that does not alter the total mix of information available will not affect the company's stock price in an efficient market. As then-Judge Alito wrote for the Third Circuit, "[i]n the context of an 'efficient' market, the concept of materiality translates into information that alters the price of the firm's stock." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997). Accord *Oran* v. *Stafford*, 226 F.3d 275, 282 (3d Cir. 2000) (Alito, J.) ("if a company's disclosure of information has no effect on stock prices, it follows that the information disclosed * * * was immaterial as a matter of law") (quotation omitted).

This Court recognized as much in *Basic*, positing this hypothetical in which the presumption of reliance would be rebutted:

> if petitioners could show that the "market makers" were privy to the truth about the merger discussions here with Combustion, and thus that the market price would not have been affected by their misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone. *Basic*, 485 U.S. at 248.

That hypothetical tracks the facts here. A statement that does not alter the reasonable investor's valuation of the stock is immaterial and cannot distort the market price in an efficient market. Therefore, it makes no sense to presume that the entire class of investors relied on the misrepresentations by relying on the market price.

5. The Court's decision last Term in *Erica P. John Fund* held that a plaintiff need not prove "loss causation" in order to trigger the presumption of reliance and declined to "address any other question about *Basic*, its presumption, or how and when it may be rebutted." 131 S. Ct. at 2187. This case presents the opportunity to ad-

dress the issues that the Court in *Erica P. John Fund* found unnecessary to reach. Those issues continue to divide the circuits and are presented cleanly here.

While *Erica P. John Fund* did not answer the question presented here, its powerful reaffirmation of *Basic*'s price-centered rationale strongly suggests that the court of appeals was wrong to certify a class based on immaterial statements. The Court declared that "*Basic*'s fundamental premise" is "that an investor presumptively relies on a misrepresentation *so long as it was reflected in the market price* at the time of his transaction." (emphasis added). *Erica P. John Fund*, 131 S. Ct. at 2186. Time and again, the Court emphasized that the fraud-on-the-market presumption is inapplicable without evidence that the alleged misrepresentations distorted the market price. *Ibid.* ("Under *Basic*'s fraud-on-the-market doctrine, an investor presumptively relies on a defendant's misrepresentation *if* that 'information is reflected in the market price' of the stock at the time of the transaction.") (emphasis added); *ibid.* (the presumption applies when "the investor purchased the stock *at a distorted price*, and *thereby* presumptively relied on the misrepresentation reflected in that price") (emphasis added). Indeed, the Court directly contrasted *Basic*'s requirement that "a misrepresentation * * * affected the integrity of the market price" with its rejection of the Fifth Circuit's requirement that the misrepresentation "also caused a subsequent economic loss." *Ibid.*

The opinion in *Erica P. John Fund* also reaffirms that "the presumption was just that, and could be rebutted by appropriate evidence." 131 S. Ct. at 2185 (citing *Basic*, 485 U.S. at 248). And it cited *Basic*'s recognition that absent a plaintiff's ability to sustain the presumption of reliance, a class cannot be certified because individualized issues of reliance will predominate. *Ibid.*

In refusing to consider whether the alleged misrepresentations were immaterial, the court of appeals certified a class where *Basic*'s "fundamental premise" of price distortion was missing. Likewise, in refusing to consider rebuttal evidence, the court ignored *Erica P. John Fund*'s reminder that *Basic* created a *rebuttable* presumption, without which classes may not be certified. A rebuttable presumption created for the purpose of aiding class certification must necessarily be rebuttable at the class-certification stage. Otherwise, the presumption would be effectively irrebuttable and classes would be routinely certified in error. Cf. *John R. Sand & Gravel Co.* v. *United States*, 552 U.S. 130, 137 (2008) ("the word 'rebuttable' means that the presumption is not conclusive"). A defendant's rebuttal of the presumption defeats class certification because individual issues of reliance predominate.

II. The Court Of Appeals' Decision Conflicts With *Wal-Mart*.

The court of appeals held that respondent was not required to prove materiality in order to trigger the presumption of reliance because materiality is a classwide, merits element of a Rule 10b-5 claim. Pet. App. 8a-10a. That reasoning fatally conflicts with this Court's recent decision in *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541 (2011).

1. For purposes of this case, *Wal-Mart* establishes two fundamental principles. First, to certify a class, a plaintiff "must affirmatively demonstrate [its] compliance" with Rule 23; it must "prove" that it "*in fact*" satisfies all of the Rule's requirements. *Wal-Mart*, 131 S. Ct. at 2551. Second, in determining whether the plaintiff has carried its burden to satisfy Rule 23, the court must often consider issues that "overlap with the merits of the plaintiff's underlying claim." *Id.* at 2551-2552. Consideration

of the merits is *verboten* only when it is unrelated to any of the Rule 23 requirements for class certification. *Id.* at 2552 n.6.

The Court in *Wal-Mart* applied these teachings to fraud-on-the-market cases, which it termed "perhaps the most common example of considering a merits question at the Rule 23 stage." 131 S. Ct. at 2552 n.6. The Court explained that in a fraud-on-the-market case, the plaintiff may seek to satisfy Rule 23(b)(3)'s predominance requirement via the presumption of reliance, but only "if the plaintiffs can establish the applicability" of the presumption. *Ibid.* The Court noted that such plaintiffs will have to show that their shares were traded on an efficient market, even though "they will surely have to prove [market efficiency] again at trial to make out their case on the merits." *Ibid.*

2. The court of appeals ignored *Wal-Mart*'s logic. *Wal-Mart* makes crystal clear that fraud-on-the-market plaintiffs may not cry "merits" or "classwide issue" as a means of escaping their burden to prove that common issues "in fact" predominate. The Court plainly recognized that market efficiency is both a merits issue and an issue that stands or falls on a classwide basis, yet a plaintiff must prove market efficiency if it is to "establish the applicability" of the presumption of reliance, and by extension, predominance of common issues. There was no principled basis for the court of appeals to require proof of market efficiency, but not the equally important presumption-of-reliance element of materiality.

The necessity of proving classwide, merits-related facts inheres in a plaintiff's choice to proceed under the presumption of reliance. A plaintiff seeking to use the presumption must necessarily make a number of classwide showings to establish that a classwide presumption makes sense: the statements must be public, material,

and received by a generally efficient market. These are all common issues that plaintiffs will have to prove again at trial in order to establish the merits element of reliance. Of course, at the class-certification stage, the district court is not considering these issues for the sake of determining the substantive merits of plaintiffs' claims, but only to determine whether they may proceed as a class.[3] Materiality, like market efficiency, presents precisely the "overlap" between merits and Rule 23 issues that *Wal-Mart* requires district courts to embrace. And as in *Wal-Mart*, the existence or not of a classwide, merits-related prerequisite to class certification cannot itself be the "glue" that binds together the class. 131 S. Ct. at 2551-2552 (rejecting certification where plaintiffs failed to show a corporate-level policy of discrimination).

In any event, a Rule 10b-5 plaintiff generally has two options for pursuing class certification. He may seek to prove actual reliance on the alleged misrepresentations and show that such actual reliance was common to class members. Or he may attempt to use the presumption of classwide reliance recognized by this Court. The latter option, while more readily achieved than the first, requires proof of merits-related elements to ensure that the

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[3] Proof of materiality for purposes of proving the substantive merits of a 10b-5 claim is properly preserved for summary judgment or trial. And a judge's rulings on materiality for certification purposes do not bind the judge or jury when they later address materiality for merits purposes. *In re Initial Public Offerings Sec. Litig.*, 471 F.3d 24, 41 (2d Cir. 2006) ("[T]he determination as to a Rule 23 requirement is made only for purposes of class certification and is not binding on the trier of facts, even if that trier is the class certification judge."); see also *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 318 n.19 (3d Cir. 2008); accord *Blades* v. *Monsanto Co.*, 400 F.3d 562, 566-567 (8th Cir. 2005).

presumption of classwide reliance is warranted, such as materiality and market efficiency. Just as a plaintiff choosing the first method may not escape Rule 23's stringent requirements, a plaintiff who elects to proceed under the judicially-created option cannot relieve himself of Rule 23's burdens merely because the option he chose requires proof that pertains to both class certification and the merits.

3. Even if a plaintiff initially triggers the presumption of reliance by making the required threshold showing (including materiality), *Wal-Mart*'s "rigorous" Rule 23 inquiry is not at an end. 131 S. Ct. at 2551. Completing the *prima facie* stage of the rebuttable presumption does not mean plaintiffs have "prove[n]" that they "*in fact*" satisfy Rule 23(b)(3)'s predominance requirement. *Ibid.*

In creating the presumption, the Court cited Federal Rule of Evidence 301. *Basic*, 485 U.S. at 245. Rule 301 states that a rebuttable presumption "does not shift the burden of persuasion, which remains on the party who had it originally," Fed. R. Evid. 301, which under Rule 23 is the plaintiff. Thus, once plaintiffs successfully trigger the presumption, defendants merely have "the burden of producing evidence to rebut the presumption." *Ibid.*[4] Under Rule 301, a defendant's rebuttal of the presumption requires that class certification be denied unless a plaintiff can show by a preponderance of the evi-

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[4] Cf. *Tex. Dept. of Cmty. Affairs* v. *Burdine*, 450 U.S. 248, 252-254 (1981) (although plaintiff may invoke a rebuttable presumption that he suffered from discriminatory acts, the defendant may rebut the presumption by any admissible evidence of non-discriminatory motive, and the "ultimate burden of persuading the trier of fact * * * remains at all times with the plaintiff").

dence that the market price was in fact distorted, and thereby carry its ultimate Rule 23 burden of showing that common issues predominate. As the Second Circuit correctly explained, "[i]f defendants attempt to make a rebuttal * * * the district judge must receive enough evidence * * * to be satisfied that each Rule 23 requirement has been met." *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 486 (2d Cir. 2008).

The court of appeals failed to ensure that respondent carried its ultimate burden to satisfy Rule 23(b)(3)'s predominance requirement. Petitioners' evidence that the alleged misrepresentations were not material constituted a rebuttal showing severing the link between the misrepresentation and the price paid. *Basic*, 485 U.S. at 248-249. That should have returned the burden of proof to respondent to establish that common issues of reliance nonetheless predominate, consistent with Rule 301 and *Wal-Mart*. Instead, by refusing to consider petitioners' rebuttal evidence, the court of appeals effectively rendered *Basic*'s presumption conclusive and improperly certified a class without imposing on respondent the ultimate burden of satisfying Rule 23's requirements.

4. Saying that materiality can be considered at summary judgment, Pet. App. 2a-3a, does not alleviate the harm of failing to decide an essential Rule 23 issue at the class-certification stage. A court is bound to deny summary judgment on materiality if there is any genuine issue of fact that the misrepresentations were material. Thus, under the court of appeals' approach, a case could proceed to trial as a class action without plaintiffs having ever had to prove that the Rule 23 prerequisite of materiality was "in fact" satisfied. Of course, given the miniscule number of class actions that go to trial, the defendant likely would be coerced into settlement long before. See Part III, *infra*.

III. Immediate Review Is Warranted To Ensure That The Presumption Of Reliance Is Not Used To Coerce Settlements Where Class-Action Treatment Is Inappropriate.

The framework set forth in *Basic* imposes carefully calibrated burdens on plaintiffs and permits defendants broad rights of rebuttal, all to ensure that class-action treatment is appropriate. Some lower courts, however, routinely misuse the *Basic* presumption as a virtual rubberstamp for class certification in Rule 10b-5 securities cases involving public companies. In the era before the Second, Third, and Fifth Circuits began putting plaintiffs to the proof required by *Basic*, at least 94% of 10b-5 class-certification motions were granted. Roosevelt, *Defeating Class Certification in Securities Fraud Actions*, 22 Rev. Litig. 405, 407 (2003). Absent this Court's intervention, that reality will continue to persist in the Ninth and Seventh Circuits, where proof of materiality is not required and defendants are barred from introducing rebuttal evidence prior to class certification.

Such a result cannot be reconciled with the notions of "fairness, public policy, * * * probability, [and] judicial economy," on which *Basic* relied in creating its presumption of reliance. 485 U.S. at 245. To defer for merits resolution questions essential to whether the case should have proceeded as a class action in the first instance is wasteful in the extreme. The Court has cautioned against further expansion of the judicially-created 10b-5 cause of action, and those concerns are magnified when lower courts expand the judicially-created presumption of reliance that allows such cases to proceed as class actions. Indeed, "[t]he practical consequences of an expansion" for defendants are stark. *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 159, 163 (2008). "[E]xtensive discovery and the potential for un-

certainty and disruption in a lawsuit allow plaintiffs with weak" securities fraud "claims to extort settlements from innocent companies." *Ibid.* (citing *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740-741 (1975)).

That prospect is grave once a class is certified. Class certification is usually the entire ballgame for defendants. Only 8% of putative class actions even reach a ruling on summary judgment.[5] "A court's decision to certify a class * * * places pressure on the defendant to settle even unmeritorious claims." *Shady Grove Orthopedic Assocs., P.A.* v. *Allstate Ins. Co.*, 130 S. Ct. 1431, 1465 n.3 (2010) (Ginsburg, J., dissenting). Judge Friendly aptly described such settlements as "blackmail." Friendly, *Federal Jurisdiction: A General View* 120 (1973). Certifying fraud-on-the-market classes without requiring plaintiffs to prove materiality or affording defendants the opportunity to rebut will inevitably lead to the settlement of countless marginal cases—indeed, cases that are not only meritless, but which never should have been certified—because the amounts at stake are simply too enormous to justify the risk of litigation. That, in turn, would give rise to more frivolous lawsuits. See Bone & Evans, *Class Certification and the Substantive Merits*, 51 Duke L.J. 1251, 1302 (2002). By requiring proof of materiality and allowing rebuttal prior to class certification, "[t]he law guards against a flood of frivolous or vexatious lawsuits." *Salomon*, 544 F.3d at 484.

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[5] Stanford Law School Securities Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings: 2011 Year in Review* 18 (2012) (hereinafter, "Stanford Clearinghouse"), *available at* http://securities.stanford.edu/clearinghouse_research/2011_YIR/Cornerstone_Research_Filings_2011_YIR.pdf.

Careful gatekeeping at the Rule 23 stage protects not only judicial efficiency and fundamental fairness; it also safeguards the productivity of the U.S. economy. In an average year during the past decade, health-care companies representing 18% of that sector's S&P 500 market capitalization were targeted in securities class actions. Stanford Clearinghouse, at 13. In 2010, the percentage skyrocketed to nearly 34%. *Ibid.* The securities laws are not intended "to provide investors with broad insurance against market losses" in huge segments of our economy. *Dura*, 544 U.S. at 345 (citing *Basic*, 485 U.S. at 252 (White, J., dissenting)). Allowing enormous classes to be certified based on a judicially-created presumption where the evidence shows that the statements were immaterial hardly deters fraud. Rather, it punishes innocent defendants (and their current shareholders) who must settle cases after certification to avoid the massive risks and expense of litigation. As this Court declared in *Dura*, a rule that promotes settlement of meritless cases improperly "transform[s] a private securities action into a partial downside insurance policy." *Id.* at 347-348. The Court should not countenance the court of appeals' adoption of such a rule in this case.

CONCLUSION

The petition should be granted.

Respectfully submitted.

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AMICUS CURIAE BRIEF

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In the Supreme Court of the United States

AMGEN INC., ET AL.,

Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF FORMER SEC COMMISSIONERS AND OFFICIALS AND LAW AND FINANCE PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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BRIEF *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF THE *AMICI CURIAE*

The *amici curiae* are former Commissioners and officials of the United States Securities and Exchange Commission (SEC), as well as prominent law and finance professors whose fields of academic inquiry include securities regulation and litigation, class-action practice, and law and economics.[1] *Amici* have devoted substantial parts of their professional careers to drafting, implementing, and/or studying the federal securities laws, including how those laws should be interpreted to ensure the protection of investors and the promotion of efficiency, competition, and capital formation.

This brief reflects the consensus view of the *amici*, who believe that this Court should grant certiorari to resolve the conflict among the federal courts of appeals and to address the doctrinal inconsistencies created by the Ninth Circuit's decision below. Each individual *amicus* may not endorse every argument presented in this brief, however. The SEC Commissioners, officials, and professors joining this brief as *amici* are listed alphabetically below:

The Honorable Paul S. Atkins served as a Commissioner of the SEC from 2002 to 2008.

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[1] Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part and that no person other than *amici* and their counsel made a monetary contribution to its preparation or submission. Counsel of record for all parties received notice at least 10 days prior to the due date of the intention of *amici* to file this brief. The consents of the parties to the submission of this brief are on file with the Clerk.

Brian G. Cartwright served as General Counsel of the SEC from 2006 to 2009.

The Honorable Charles C. Cox served as a Commissioner of the SEC from 1983 to 1989, and as Chief Economist of the SEC from 1982 to 1983.

Professor Richard A. Epstein is the Laurence A. Tisch Professor of Law at New York University School of Law, the James Parker Hall Distinguished Service Professor of Law Emeritus and Senior Lecturer at the University of Chicago Law School, and the Peter and Kirsten Bedford Senior Fellow at the Hoover Institution.

The Honorable Joseph A. Grundfest is the William A. Franke Professor of Law and Business at Stanford Law School and served as a Commissioner of the SEC from 1985 to 1990. Professor Grundfest is also founder and principal investigator of the Stanford Securities Fraud Class Action Clearinghouse, an award winning website that tracks class action federal securities fraud activity. He is also founder and senior faculty at the Rock Center on Corporate Governance at Stanford University.

The Honorable Philip R. Lochner, Jr., served as a Commissioner of the SEC from 1990 through 1991.

The Honorable Aulana L. Peters served as a Commissioner of the SEC from 1984 through 1988.

Professor Kenneth E. Scott is the Ralph M. Parsons Professor of Law and Business Emeritus at Stanford Law School and Senior Research Fellow Emeritus at the Hoover Institute.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Ninth Circuit's decision in this case strikes at the heart of this Court's holding in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988). *Basic* recognized that in order to benefit from a presumption of class-wide reliance, a securities fraud plaintiff must show at the class certification stage that the essential predicates to the fraud-on-the-market theory have been satisfied. The crux of the fraud-on-the-market theory is that, in an efficient market, all public *material* information will be reflected in the price of a security. An investor who purchases a security relying on the integrity of its market price relies on any *material* misrepresentations that have been made to the market. If, however, the value of a security reacts to *immaterial* information, then by definition the market in that security is not efficient and *Basic*'s presumption of class-wide reliance does not apply. Materiality is thus a critical component of the very theory that makes class certification of Section 10(b) claims possible. *Basic* recognized that any showing that severs the link between an alleged misrepresentation and the market price of a security—including a showing that a misrepresentation was immaterial—rebuts the presumption of reliance and makes class certification improper. The Ninth Circuit failed to follow these important principles when it held that a Section 10(b) plaintiff need not demonstrate materiality in order to obtain class certification.

The Ninth Circuit's misunderstanding of *Basic* has significant implications. Securities class actions are almost always settled once a class is certified, because the risks to a defendant of going to trial are so substantial. In consequence, the materiality of an al-

leged misstatement will in practice never be tested, beyond the pleading requirements, unless it is tested as part of the Rule 23 inquiry. Plaintiffs' allegations of reliance therefore will never be tested either. The Ninth Circuit's decision unleashes the considerable *in terrorem* power of class certification to compel settlement of even questionable claims without any meaningful inquiry into materiality or reliance - though *Basic* establishes that these are critical issues at the class certification stage.

These issues, moreover, are treated differently in different parts of the country. The Ninth and Seventh Circuits hold that materiality is a merits question that is not to be considered when a court is deciding whether to certify a class action. The Second and Fifth Circuits hold that a plaintiff must demonstrate that the alleged misrepresentation is material before a class may be certified. And the Third Circuit, though it does not require a plaintiff affirmatively to demonstrate materiality at the Rule 23 stage, gives a defendant the opportunity to rebut the presumption of reliance, and thereby defeat class certification, by showing the lack of materiality.

The data shows that this three-way conflict affects the vast majority of federal securities fraud actions. The five circuits that have now decided whether materiality must be shown at the class certification stage account for some three quarters of all securities fraud class actions filed in the federal courts, measured either by number of suits or by the dollar value of the resulting settlement exposure.

This deep and persistent conflict invites forum shopping—both by plaintiffs seeking to avail themselves of the Ninth and Seventh Circuits' liberal approach to class certification of Section 10(b) claims,

and by defendants who would prefer to be in the Second, Third or Fifth Circuits. The weaker the plaintiffs' materiality argument, the greater the incentive of both parties to engage in strategic behavior that ultimately hinders the efficient administration of justice.

Amici urge this Court to grant certiorari to resolve this sharp difference of judicial opinion affecting one of the principal sources of class action litigation.

ARGUMENT

The questions presented by petitioners arise from a conflict among the federal courts of appeals. Five different circuits have expressed three different views regarding the requirement that plaintiffs demonstrate materiality as a precondition to class certification in a securities fraud class action that relies on the rebuttable presumption of reliance created by this court's decision in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988). *Amici* present data in Part I demonstrating that this conflict implicates the large majority of federal securities fraud litigation activity and warrants this Court's attention because of the doctrinal and practical tensions that the circuit split creates in the administration of justice. We show in Part II that the Ninth Circuit's decision that plaintiffs need not demonstrate that a misstatement is material in order to obtain class certification of a Section 10(b) claim creates irreconcilable conflicts with this Court's precedents and threatens great harm by increasing the pressure on defendants to pay large settlements to resolve questionable claims. To resolve the clear conflict on an important issue involving suits under the federal securities laws, this

Court should grant certiorari. See Sup. Ct. Rule 10(a).

I. THIS COURT SHOULD RESOLVE THE CONFLICT AMONG THE CIRCUITS CONCERNING THE ROLE OF MATERIALITY AT THE CLASS CERTIFICATION STAGE OF SECTION 10(b) ACTIONS.

1. As petitioners have demonstrated and we will not repeat in detail, there is a deep and well-entrenched conflict among the federal courts of appeals as to how the materiality element of the Section 10(b) cause of action is to be treated at the class certification stage of litigation. That conflict has been exacerbated by the decision of the Ninth Circuit in this case.

The Ninth Circuit here, and the Seventh Circuit in *Schleicher* v. *Wendt*, 618 F.3d 679 (7th Cir. 2010), have squarely held that materiality is a merits question that is not to be considered when a court is determining whether to certify the case for class adjudication. In so holding, the Ninth Circuit acknowledged that it was rejecting the contrary positions of the Second and Fifth Circuits. Those circuits both hold that a plaintiff must demonstrate that the alleged misrepresentation is material before a class may be certified (and, concomitantly, that a defendant may rebut any such showing to defeat certification). See *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008); *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007). And the Third Circuit imposes no burden to show materiality on plaintiffs, but does give a defendant the opportunity to rebut the fraud-on-the-market presumption of reliance, and thereby defeat class certification, by demonstrating a lack of mate-

riality at the Rule 23 stage. See *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623 (3d Cir. 2011).

The First and Fourth Circuits also have stated, in *dicta*, that plaintiffs must demonstrate materiality at the class certification stage. See *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 7 n.11 (1st Cir. 2005); *Gariety* v. *Grant Thornton LLP*, 368 F.3d 356, 364 (4th Cir. 2004).

This circuit split—creating different standards for class certification of securities fraud claims in different parts of the country—has significant consequences. Disparate class certification standards are of great practical importance, for as we discuss in Part II, certification of a securities fraud class action essentially ensures that a case will be settled and the merits will never be adjudicated—a result that, with "vanishingly rare exception," is virtually guaranteed even if plaintiffs' claims are weak. Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. REV. 97, 99 (2009). Class certification also sets in motion costly merits discovery and increases the potential for significant disruption to the defendant's business, thereby substantially increasing the value of the case in settlement. Of course, once a class is certified the need to settle with the entire class, rather than with those shareholders willing to bring an individual action, also increases the stakes for the defendant.

2. The implications of this circuit split are not merely doctrinal, and are susceptible of precise empirical quantification. In particular, as demonstrated in Table 1 set forth in the appendix, the two circuits (the Second and Fifth) that have held that plaintiffs must make an adequate showing of materiality at the class certification stage in order to benefit from

Basic's rebuttable presumption of reliance account for 38 percent of all securities fraud class action litigation cases brought from January 1, 1996 (the effective date of the Private Securities Litigation Reform Act of 1995) through year-end of 2011. These same two circuits account for 49 percent of the settlements of federal class action securities fraud litigation filed during that same time period. Thus, measured by the dollar value of settlement exposure, the federal circuits are split roughly in half.[2] Approximately half of the historic value of federal class action securities fraud litigation is now subject to a requirement that plaintiffs make an adequate showing of materiality. Meanwhile, another half is subject to a weaker standard, or is litigated in a circuit that has no formal holding addressing the question.

The circuits holding that materiality is not to be considered during the class certification stage, the Seventh and the Ninth, account for 27 percent of the cases filed and 16 percent of the dollar value of settlements. The Third Circuit, which takes the intermediate position allowing defendants to rebut materiality without requiring that plaintiffs make a showing of materiality, accounts for 8 percent of filings and 10 percent of the dollar value of settlements.

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[2] If the two circuits that have, in *dicta*, expressed support for the requirement that plaintiffs make a showing (the First and the Fourth) are included within the category of circuits requiring a showing of materiality as a precondition to class certification, then the percentage of cases filed subject to this requirement increases to 46 percent and the percentage of the dollar value of settlements subject to this requirement increases to 60 percent.

Only 19 percent of cases representing 14 percent of the dollar value of settlements were filed in circuits that have not expressed a view, in holdings or in *dicta*, regarding the circuit split implicated by the decision below. Over time, unless this split is resolved by this Court, each of these circuits will, perforce, be required to stake out a position that can only exacerbate the practical significance of this circuit conflict.

These statistics demonstrate that the conflict among the circuits that petitioners ask this Court to resolve is a serious one. Indeed, it has the potential to affect the outcome of a substantial proportion of all the class actions that are filed in the federal courts. See John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 COLUM. L. REV. 1534, 1539-1540 (2006) (constituting almost half of all class actions in federal courts, securities fraud class actions are "the 800-pound gorilla that dominates and overshadows other forms of class actions" and "disproportionately claim[s] judicial time and attention"). Such a sharp division of judicial opinion, involving a statutory provision that is one of the principal sources of class action litigation in the Nation, and affecting such a high proportion of that litigation, cries out for resolution by this Court. See, *e.g.*, *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 340 (2005) (granting certiorari in a Section 10(b) case "[b]ecause the Ninth Circuit's views about loss causation differ from those of other Circuits").

3. So long as this circuit conflict remains unresolved by this Court, it invites forum shopping by securities fraud plaintiffs. Given the liberal venue provisions of the federal securities laws, plaintiffs'

counsel in most Section 10(b) suits can file in any circuit they choose. To be sure, most cases are today resolved by the courts in which corporate defendants are headquartered. See Matthew D. Cain & Stephen M. Davidoff, *A Great Game: The Dynamics of State Competition and Litigation* 41 Tables 9A & B (Jan. 2012).[3] But the continued persistence of such a dramatic split on a question of law that can have a profound effect on the value of a class action claim will predictably create an incentive for plaintiffs to gravitate to those circuits in which it is easier to obtain class certification.

Plaintiffs who doubt their ability to prove by a preponderance of the evidence that the misrepresentations they allege meet the legal standard of materiality will have particular reason to file in circuits where they will not have to prove materiality in order to generate the "hydraulic pressure on defendants to settle" that comes with class certification of their claims. *Newton* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 164 (3d Cir. 2001). Equally predictably, litigation over the appropriate venue of Section 10(b) suits will increase, as defendants seek to transfer suits filed in the Ninth and Seventh Circuits, invoking "the convenience of parties and witnesses" pursuant to 28 U.S.C. § 1404(a)—venue challenges that are especially likely if a defendant is headquartered in the Second, Third, or Fifth Circuit. A uniform national rule would address these concerns, leveling the playing field across the country, and promoting the efficient administration

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[3] Unpublished working paper available at http://papers.ssrn.com/so13/papers.cfm?abstract_id=1984758.

of justice by eliminating a reason to engage in strategic forum shopping behavior.

II. THE NINTH CIRCUIT'S DECISION CONFLICTS WITH *BASIC* AND WITH THIS COURT'S SECTION 10(b) AND CLASS ACTION JURISPRUDENCE.

1. A misrepresented or omitted fact is material if there is a "substantial likelihood" that it "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976); accord *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1318 (2011). When this Court in *Basic* adopted this definition of materiality for Section 10(b) claims, "[t]he paradigm of a fraud on the market litigation [was] a class action brought by purchasers of stock alleging that over a period of time the stock prices were artificially inflated due to material misstatements contained in publicly available corporate documents." Barbara Black, *Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C. L. REV. 435, 435-437 (1984) (cited in *Basic*, 485 U.S. at 247 n.26). *Basic* itself involved a claim that a corporation had misled investors—artificially depressing the price of its stock by making false representations about the material question of whether there was a plan for the corporation to be acquired.

The materiality of the alleged misrepresentations was essential to *Basic*'s holding that reliance on misrepresentations may be presumed under the fraud-on-the-market theory when the market is efficient. Indeed, the Court's explanation that considerations of "common sense and probability" support a

presumption of reliance makes sense only when plaintiffs have traded shares "after the issuance of a materially misleading statement by the corporation." 485 U.S. at 226, 246. Were a stock price moved by a misstatement of *immaterial* fact that did not affect the issuer's fundamental value—or were it not moved by a material misstatement—neither "common sense" nor "probability" would support a presumption of reliance: the market in that stock would by definition be inefficient. See, *e.g.*, ANDREI SHLEIFER, INEFFICIENT MARKETS: AN INTRODUCTION TO BEHAVIORAL FINANCE 5 (2000) (a key prediction of efficient market theory is that "prices should not move without any news about the value of the security"); Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 509 (2006) ("The definition of immaterial information * * * is that it is already known or * * * does not have a statistically significant effect on stock price in an efficient market").

"Reliance by the plaintiff upon the defendant's deceptive acts * * * ensures that, for liability to arise, the 'requisite causal connection between a defendant's misrepresentation and a plaintiff's injury' exists as a predicate for liability." *Stoneridge Inv. Partners* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008), quoting *Basic*, 485 U.S. at 243. Reliance may be presumed under the fraud-on-the-market theory only when the misrepresentation "is reflected in the market price of the security," because only then can it "be assumed that an investor who buys or sells stock at the market price relies upon the statement." *Ibid.* Unless a misstatement is *material*, "the basis for finding that the fraud had been transmitted through market price would be gone." *Basic*, 485 U.S. at 248.

Indeed, *Basic* makes it crystal clear that "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance." 485 U.S. at 248. As an example of such a showing, this Court explained in *Basic* that "if petitioners could show that the 'market makers' were privy to the truth * * * and thus that the market price would not have been affected by their misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone." *Ibid.* But that is precisely the showing that the Ninth Circuit now prevents any defendant from making at the class certification stage in any class action securities fraud litigation.

Basic also explains that "if, despite * * * allegedly fraudulent attempt[s] to manipulate market price, news * * * credibly entered the market and dissipated the effects of the misstatements, those who traded * * * after the corrective statements would have no direct or indirect connection with the fraud." 485 U.S. at 248. Here too, the Ninth Circuit's holding would preclude a defendant from making the very showing contemplated by this Court as a means of rebutting the presumption of reliance.

That the materiality of an alleged misstatement is a key element in supporting the presumption of reliance at the merits stage of a Section 10(b) suit logically means that it is a key element at the class certification stage as well. As the drafters of Rule 23 explained, the "critical need" at the class certification stage is to determine "the nature of the issues that actually will be presented at trial"—"how the case

will be tried." Fed. R. Civ. P. 23, Cmte. Notes to the 2003 Amendments. As *Basic* establishes, a Section 10(b) case can *only* be tried in a class action format if the presumption of reliance is applicable. Otherwise, individual issues of reliance will predominate over common issues and Rule 23(b)(3) will not be satisfied. See *Basic*, 485 U.S. at 242 (the need for "proof of individualized reliance from each member of the proposed class" would have "prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones"); see also *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179, 2184 (2011) ("[w]hether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance"). If a representation is not material, there is no reason to think that all members of the trading community relied on it, or indeed that any of them did, and their reliance is not a common issue that binds together their claims.

2. The position of the Seventh and Ninth Circuits that no inquiry into materiality need be made at the class certification stage is also at odds with this Court's recent decision in *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541 (2011). The Court made clear in *Wal-Mart* that class certification is proper only if the plaintiff "affirmatively demonstrate[s] his compliance with [Rule 23]—that is, he must be prepared to prove" that common issues will predominate at trial, and therefore "to prove," in a Section 10(b) case, that the presumption of reliance will apply. *Id.* at 2551. Accordingly, because materiality *must* be shown before the fraud-on-the-market presumption applies to make reliance a common issue, it also *must* be shown at the Rule 23 stage before a class may be certified.

That materiality is both a merits and a class certification issue is of no moment. "Frequently," this Court has observed, the "'rigorous analysis'" essential at the class certification stage "will entail some overlap with the merits of the plaintiff's underlying claim. That cannot be helped," "[n]or is there anything unusual about that consequence: The necessity of touching aspects of the merits in order to resolve preliminary matters" is "a familiar feature of litigation." *Id.* at 2551-2552.

Indeed, this Court in *Wal-Mart* described the fraud-on-the-market theory of reliance as "the most common example of considering a merits question at the Rule 23 stage." 131 S. Ct. at 2552 n.6. It observed that Section 10(b) plaintiffs "seeking [Rule] 23(b)(3) certification must prove that their shares were traded on an efficient market" in order to "invoke [the fraud-on-the-market] presumption," "an issue they will surely have to prove *again* at trial in order to make out their case on the merits." *Ibid.*

3. The *practical* effect of stripping materiality out of the equation at the class certification stage, as the Ninth and Seventh Circuits have done, would be to "[a]llo[w] plaintiffs to circumvent the reliance requirement" altogether and thereby to "disregard the careful limits on 10b-5 recovery mandated by [this Court's] earlier cases." *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180 (1994). That is because class actions seeking substantial damages are almost always settled, with the result that the materiality of an alleged misstatement, if not tested at the Rule 23 stage, will never be tested at all beyond the pleading requirements.

It is well understood that, if a class is certified in a securities fraud case, the risks of trial to the defen-

dant are so significant that settlement is usually the defendant's only option. *E.g.*, Fed. R. Civ. P. 23(f), 1998 Cmte. Note ("An order granting certification" may "force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability"). This Court has recognized that "[e]ven weak cases brought under [Rule 10b-5] may have substantial settlement value." *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Dabit*, 547 U.S. 71, 80 (2006). The "*in terrorem*" prospect of "extensive discovery," "disruption of normal business activities," and the risk of a potentially massive adverse jury verdict gives even an insubstantial claim "a settlement value to the plaintiff out of any proportion to its prospect of success at trial." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740-743 (1975). And these large settlements are "'payable in the last analysis by innocent investors'"—the defendant company's current shareholders. *Id.* at 739, quoting *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968).

No one doubts that "'blackmail settlements,'" "induced by a small probability of an immense judgment," are a serious problem with the class action device in large securities fraud cases. *In re Rhone-Poulenc Rohrer, Inc.*, 51 F.3d 1293, 1298 (7th Cir. 1995), quoting HENRY J. FRIENDLY, FEDERAL JURISDICTION: A GENERAL VIEW 120 (1973); see THOMAS E. WILLGING, ET AL., EMPIRICAL STUDY OF CLASS ACTIONS IN FOUR FEDERAL DISTRICT COURTS: FINAL REPORT TO THE ADVISORY COMMITTEE ON CIVIL RULES 179, Tables 39 & 40 (Federal Judicial Center 1996). The costs and risks of litigation make the merits of such claims largely irrelevant. *E.g.*, Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV.

497, 516-517 (1991); Joseph A. Grundfest, *Why Disimply?*, 108 HARV. L. REV. 727, 742-743 (1995). Once a class is certified the risks of the suit are magnified and settlement becomes the predictable outcome.

Securities fraud actions are not intended "to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause"—*i.e.*, losses caused by misrepresentations of *material* fact. *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 345 (2005), citing *Basic*, 485 U.S. at 252. But taking materiality out of the equation at the class certification stage means in practice that materiality need only be adequately pled, never proved, even though it is an essential ingredient of the presumption needed to establish reliance on a common, class-wide basis. Courts must "be especially alert" to prevent this sort of "class-action harassment." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 345 (1979).

This Court has often taken account of the "practical consequences" of different approaches to the Section 10(b) private cause of action. *Stoneridge*, 552 U.S. at 163; see *Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1104-1105 (1991). These adverse consequences of the Ninth Circuit's ruling strongly suggest that its decision misinterprets Section 10(b) and Rule 23.

4. Insisting that materiality be shown at the class certification stage would serve both of Congress's "twin goals" of "curb[ing] frivolous, lawyer-driven litigation" and "preserving investors' ability to recover on meritorious claims." *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007). Insisting that materiality be shown before settlement pressure is ratcheted up significantly by the certifi-

cation of a class action will provide a disincentive to the filing of questionable claims over nonmaterial statements. At the same time, the requirement for making such a showing in accordance with *Basic* would not impose a material burden on any plaintiff with a clearly meritorious claim.

In particular, in order to prevail in an action for damages under Section 10(b), the plaintiff will have to demonstrate, at a minimum, "that the price on the date of purchase was inflated because of the misrepresentation." *Dura*, 544 U.S. at 342. This showing can generally be made with expert economic analysis —the same sort of event studies that plaintiffs' experts will in any event have to conduct in order to satisfy other requirements for showing at the class certification stage that the market in defendant's stock was efficient and that the fraud-on-the-market presumption is warranted. Indeed, in order to prevail on the merits plaintiffs will have to prove much more, including that the alleged misrepresentation proximately caused the alleged loss. *Id.* at 342-346. The requirement that plaintiff demonstrate materiality at the class certification stage therefore does not add to the ultimate burden imposed on the plaintiff class: it changes only the timing of the necessary showing, in a modest fashion consistent with this Court's direction in *Basic*. The incremental burden on plaintiffs in showing materiality to satisfy Rule 23 is thus insignificant compared to the settlement pressure imposed on a defendant once a class is certified.

Postponing the materiality inquiry to a merits stage that in the vast majority of securities fraud cases will never take place "ultimately result[s] in more harm than good." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 214 n.33 (1976). Requiring proof of ma-

teriality to obtain class certification comports with this Court's preference that deficiencies should "'be exposed at the point of minimum expenditure of time and money by the parties and the court,'" before litigation burdens and risks "push cost-conscious defendants to settle even anemic cases." *Bell Atl. Corp.* v. *Twombly*, 550 U.S. 544, 558-559 (2007), quoting 5 CHARLES A. WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE & PROCEDURE § 1216, at 233-234 (3d ed. 2004). It comports too with this Court's insistence that it is "indispensible" that all of Rule 23's requirements for class certification be subjected to "rigorous analysis." *Wal-Mart*, 131 S. Ct. at 2551; *Gen. Tel. Co.* v. *Falcon*, 457 U.S. 147, 160-161 (1982).

The Ninth Circuit's failure to follow these precedents, to pay more than lip service to *Basic*, or to heed this Court's repeated warnings that caution is needed in cases involving the judicially implied private right of action under Section 10(b) warrant this Court's immediate intervention.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted.

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APRIL 2012

APPENDIX

TABLE 1

CIRCUIT POSITIONS	Class Action Securities Fraud Litigation Activity : 1/1/96–12/31/11			
	Cases Filed		Settlements	
	Number	Percent	Dollar [millions]	Percent
Plaintiffs Must Show Materiality				
Second Circuit[1]	1,111	33%	19,294.5	33%
Fifth Circuit[2]	199	6%	9,850.3	17%
Total	1,310	38%	29,114.8	49%
Defendant May Rebut Materiality Even if Plaintiff Makes No Showing				
Third Circuit[3]	259	8%	6,035.7	10%
Total	259	8%	6,035.7	10%

CIRCUIT POSITIONS	Class Action Securities Fraud Litigation Activity : 1/1/96–12/31/11			
	Cases Filed		Settlements	
	Number	Percent	Dollar [millions]	Percent
Materiality Is Not Considered				
Seventh Circuit[4]	148	4%	1,547.4	3%
Ninth Circuit[5]	769	23%	7,648.0	13%
Total	917	27%	9,195.4	16%
Dicta: Plaintiffs Must Show Materiality				
First Circuit[6]	158	5%	4,701.1	8%
Fourth Circuit[7]	108	3%	1,947.8	3%
Total	266	8%	6,648.9	11%

Cont'd

CIRCUIT POSITIONS	Class Action Securities Fraud Litigation Activity : 1/1/96–12/31/11			
	Cases Filed		Settlements	
	Number	Percent	Dollar [millions]	Percent
No Position				
Sixth Circuit	149	4%	2,598.2	4%
Eighth Circuit	118	3%	2,256.2	4%
Tenth Circuit	98	3%	1,178.9	2%
Eleventh Circuit	279	8%	2,191.0	4%
D.C. Circuit	19	1%	93.6	0%
Total	663	19%	8,317.9	14%
TOTAL	3,406	100%	59,342.6	100%

Notes:

[1] *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008).
[2] *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261, 265 (5th Cir. 2007), abrogated on other grounds by *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179 (2011).
[3] *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 631 (3d Cir. 2011).
[4] *Schleicher* v. *Wendt*, 618 F.3d 679, 685 (7th Cir. 2010).
[5] *Connecticut Retirement Plans & Trust Funds* v. *Amgen, Inc.*, 660 F.3d 1170 (9th Cir. 2011).
[6] *In re Polymedica Corp. Sec. Litig.*, 432 F.3d 1, 7, 11 (1st Cir. 2005).
[7] *Gariety* v. *Grant Thornton, LLP*, 368 F.3d 356, 364 (4th Cir. 2004).

AMICUS CURIAE BRIEF

RECORD
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Supreme Court, U.S.
FILED
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No. 11-1085

IN THE

Supreme Court of the United States

AMGEN INC., KEVIN W. SHARER, RICHARD D. NANULA, ROGER M. PERLMUTTER, and GEORGE J. MURROW,
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

On Petition for a Writ of Certiorari to The United States Court of Appeals For the Ninth Circuit

BRIEF OF WASHINGTON LEGAL FOUNDATION AND ALLIED EDUCATIONAL FOUNDATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

1. Whether, in a misrepresentation case under SEC Rule 10b-5, the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory.

2. Whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

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INTERESTS OF *AMICI CURIAE*

The Washington Legal Foundation (WLF) is a non-profit public interest law and policy center with supporters in all 50 states.[1] WLF devotes a substantial portion of its resources to defending free-enterprise, individual rights, and a limited and accountable government.

To that end, WLF has appeared before this and other federal courts in numerous cases raising issues related to the proper scope of the federal securities laws. *See, e.g., Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011); *Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869 (2010); *Stoneridge Inv. Partners, LLC v. Scientific Atlanta, Inc.*, 532 U.S. 148 (2008); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336 (2005). WLF has also participated extensively in litigation in support of its view that federal courts should not certify cases as class actions unless the plaintiffs can demonstrate that they have satisfied each of the requirements of Rule 23 of the Federal Rules of Civil Procedure. *See, e.g., Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011).

The Allied Educational Foundation (AEF) is a non-profit charitable and educational foundation based in Englewood, New Jersey. Founded in 1964, AEF is

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[1] Pursuant to Supreme Court Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part; and that no person or entity, other than *amici* and their counsel, made a monetary contribution intended to fund the preparation or submission of this brief. All parties have consented to this filing; letters of consent have been lodged with the Court. More than ten days prior to the due date, counsel for *amici* provided counsel for Respondent with notice of *amici*'s intent to file.

dedicated to promoting education in diverse areas of study, and has appeared as *amicus curiae* in this Court on a number of occasions.

WLF and AEF are concerned by the proliferation of class action lawsuits being filed in federal court – particularly lawsuits alleging securities fraud – and the inhibiting effect that such suits can have on the development and expansion of business. They believe that the district court's certification decision, if allowed to stand, will exacerbate that trend by encouraging efforts to certify inappropriate, unwieldy classes. A decision to certify such a class is often outcome determinative, because it creates enormous pressure on defendants to settle the suit without regard to the underlying merits.

STATEMENT OF THE CASE

Respondent Connecticut Retirement Plans and Trust Funds alleges that Petitioners (collectively, "Amgen") violated federal securities laws by issuing misleading information (and omitting material information) regarding two of Amgen's biologics. Respondent alleges that Amgen's violations caused it to purchase Amgen stock at an inflated price, and it thereby suffered losses.

Respondent sought certification of a plaintiff class consisting of all those who purchased Amgen stock between April 22, 2004 (the date of Amgen's first alleged misrepresentation) and May 10, 2007 (the date on which the truth allegedly was fully disclosed). Respondent relied upon the fraud-on-the-market theory

when seeking class certification. It argued that the court could presume that members of the proposed class relied on Amgen's misrepresentations – regardless whether they ever heard the misrepresentations – because the stock traded in an open and developed securities market, such that the price they paid for their stock would likely include a premium reflecting the market's awareness of and reliance on the misrepresentations.

The district court granted the certification motion in August 2009, finding that Respondent met the prerequisites of FRCP 23(a) and 23(b)(3). Pet. App. 15a-50a. In particular, the court determined that Respondent met Rule 23(b)(3)'s "predominance" requirement because – based on the fraud-on-the-market theory – Respondent was entitled to a presumption that all class members relied on Amgen's alleged misrepresentations. *Id.* at 31a-40a. It stated that Respondent was entitled to that presumption because Respondent had established that class members purchased their securities on an "efficient market." *Id.* at 40a. It explained, "[T]he Court agrees with Plaintiff that to trigger the presumption of reliance, Plaintiff need only establish that an efficient market exists. Other inquiries into issues such as materiality and loss causation are properly taken up at a later stage in this proceeding." *Id.*

The court held further that Amgen would not be permitted an opportunity, at the certification stage, to rebut the presumption by attempting to demonstrate that "the truth" was known to the market throughout all or most of the class period. *Id.* at 40a-44a. Rather,

the court said, a party opposing class certification is not permitted to have its rebuttal evidence considered until the summary judgment stage. *Id.* at 44a. The court explained that if it were to allow Amgen "to present evidence that none of the investors were misled because the truth was on the market, the Court would essentially be allowing [Amgen] to assert a defense of non-reliance as a basis for denial of class certification. But such is not allowed." *Id.*

The Ninth Circuit affirmed. Pet. App. 1a-13a. It held that the only elements of the fraud-on-the-market presumption are "whether the securities market was efficient and whether the defendant's purported falsehoods were public." *Id.* at 9a. The court rejected arguments that the availability of the presumption was dependent on proving that the alleged misstatements were material, *i.e.*, that the market was actually misled by and relied on the misstatements. *Id.* at 12a. The court reasoned that materiality is a "merits" question that can be determined on a class-wide basis and thus is inappropriate for consideration at the class certification stage. *Id.* at 8a-9a. It explained, "As for the element of materiality, the plaintiff must plausibly allege – but need not *prove* at this juncture – that the claimed misrepresentations were material." *Id.* at 2a. The court further held that any effort by defendants to rebut materiality is premature at the class certification stage but instead may only be made at trial or "by summary judgment motion if the facts are uncontested." *Id.* at 12a-13a.

REASONS FOR GRANTING THE PETITION

The petition raises issues of exceptional importance. In affirming class certification, the Ninth Circuit adopted a distinctly minority view among the federal appeals courts regarding what must be shown to meet FRCP 23(b)(3)'s predominance requirement in a securities law class action. The court held that certification is mandated under a fraud-on-the-market theory whenever the plaintiff demonstrates that the securities market was efficient and that the defendant's purported falsehoods were public. If those showings are made, it is immaterial how much evidence there is that the alleged falsehoods were not deemed material by the market; the class must be certified. The shortcomings of that rule are obvious: since the market for the common stock of virtually every large corporation is likely to be efficient, all but the most dull plaintiffs' lawyer will *always* be able to win class certification– all he/she need do is point to some public statement of the corporate defendant and allege that the statement was misleading and caused stock prices to be artificially inflated. And once the shareholder class is certified, public corporations face overwhelming pressures to settle even the most insubstantial claims.

The Petition thoroughly documents the sharp split among the federal circuits regarding the outcome-determinative issues raised by this case: whether fraud-on-the-market class certification under FRCP 23(b)(3) requires proof that the allegedly misleading statements were material, and whether a defendant is permitted to oppose certification by submitting evidence designed to rebut a finding of materiality. *Amici* will not repeat the

evidence of a sharp circuit split, which the Ninth Circuit expressly conceded. Pet. App. 10a-11a.

Amici write instead to highlight the conflict between the decision below and the decisions of this Court. The Court first addressed the fraud-on-the-market theory in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). The Court concluded that the theory supported application of a "rebuttable presumption of reliance" when a plaintiff makes the requisite showings, and thus that "[i]t is not inappropriate" for a district court to apply the presumption, subject to rebuttal. 485 U.S. at 250. Contrary to the Ninth Circuit, *Basic* makes no suggestion that a defendant's rebuttal must be deferred to trial. In a decision issued last year, the Court reiterated a defendant's right to rebuttal and explicitly conditioned any presumption of investor reliance on a finding that the defendant's misrepresentation is "reflected in the market price at the time of [the investor's] transaction." *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2185, 2186 (2011). Misrepresentations will not, of course, be reflected in the market price if they are not "material." Review is warranted to resolve the conflict between the decisions of this Court and the Ninth Circuit's understanding of the materiality requirement.

Review is also warranted because of the crucial role that certification decisions play in the outcome of high-stakes securities law class-action litigation. Empirical research demonstrates that litigation costs make it very difficult for the party that loses the class certification decision to continue with the litigation – with the result that erroneous certification decisions are

often effectively unreviewable. In light of that concern, *amici* urge the Court to use this opportunity to adopt clear rules that will encourage district judges to grant class certification motions only after they have determined that all the requirements of Rule 23 have been satisfied.

I. THE DECISION BELOW CONFLICTS WITH THIS COURT'S CASE LAW REGARDING THE PRESUMPTION OF RELIANCE

Respondent asserts the right to sue Amgen not only on its own behalf but also as a representative of the thousands of others who purchased Amgen stock during a three-year period beginning in April 2004. FRCP 23 imposes numerous requirements on those seeking to maintain such a representative action, including (under the circumstances of this case) a judicial finding "that the questions of law or fact common to class members predominate over any questions affecting only individual members." FRCP 23(b)(3). Certification of a class is appropriate only if "the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied." *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551 (2011) (quoting *General Tel. Co. Southwest v. Falcon*, 457 U.S. 147, 161 (1982)).

To prevail in a securities fraud action, a plaintiff must demonstrate, among other things, that he *relied* on the defendant's misrepresentation. *Dura Pharms. v. Broudo*, 544 U.S. 336, 341-42 (2005). Thus, to meet Rule 23(b)(3)'s predominance requirement, a plaintiff needs to demonstrate that reliance can be established on

a class-wide basis, because if reliance can only be established on a plaintiff-by-plaintiff basis, questions of law or fact common to class members could never be deemed to "predominate" over questions affecting only individual members. *Basic*, 485 U.S. at 242. In sum, whether Respondent is entitled to a presumption of reliance is very much a Rule 23(b)(3) class certification issue, because Respondent cannot meet the "predominance" requirement (and thus is not entitled to certification) unless it is afforded that presumption.

A. *Basic* and *Erica P. John Fund* Indicate That Evidence Rebutting the Presumption of Reliance Is Not Premature at the Class Certification Stage

The Court's 1988 decision in *Basic* endorsed the "general validity" of the fraud-on-the-market theory and held that, under appropriate circumstances, the theory supports recognition of a presumption of reliance in securities fraud cases. 485 U.S. at 242. The Court described the theory as follows:

> The fraud on the market theory is based on the hypothesis that, in an open and developed market, the price of a company's stock is determined by the available information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . . The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a

> case is no less significant than in a case of direct reliance on misrepresentations.

Id. at 241-42 (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986)).

The Court determined that: (1) "it is not inappropriate to apply a presumption of reliance supported by the fraud-on-the-market theory"; (2) that presumption is "rebuttable"; and (3) the district court's initial certification of the class "was appropriate when made but is subject on remand to such adjustment, if any, as developing circumstances demand." *Id.* at 250. Although the Court upheld the trial court's class certification decision, nothing in the Court's summation of its holdings suggested that a defendant's efforts to rebut the presumption of reliance are premature at the class certification stage.

Indeed, numerous passages in the decision point in the opposite direction. For example, *Basic* on several occasions (and in connection with its ruling that the presumption of reliance was rebuttable) emphasized that a class certification order is subject to revision at all times prior to final judgment. *See, e.g., id.*. at 250 (class certification is subject on remand to adjustments "as developing circumstances demand"). Those passages indicate that the Court contemplated that defendants should *not* be required to wait for trial before attempting to rebut the presumption of reliance.

In contrast, the Ninth Circuit held that it is "premature" for a defendant, at the class certification stage, to seek to rebut the presumption of reliance (and

thus to demonstrate a lack of predominance) by introducing evidence that the allegedly misleading statements were not material (and thus were not relied on by the market). Pet. App. 12a-13a. Rather, the Ninth Circuit held, such rebuttal evidence may only be presented at trial. *Id.* That holding is in significant tension with the passages from *Basic* cited above.

The Ninth Circuit's rejection of Amgen's efforts to raise a truth-on-the-market defense is particularly problematic. While conceding that a truth-on-the-market defense negates a stock fraud claim by demonstrating that the market was fully aware of Amgen's financial condition and thus that market price was unaffected by any misrepresentation, the appeals court concluded that such evidence is merely "a method of refuting an alleged misrepresentation's materiality" and may not be introduced to defeat class certification. *Id.* at 13a. But properly understood, the truth-on-the-market theory is both a defense on the merits *and* an appropriate basis for rebutting the presumption of reliance (and thus relevant in determining whether the Rule 23 requirements have been met). The theory postulates that a misrepresentation cannot have a fraudulent effect on a stock's value after information contrary to the misrepresentation becomes known to an efficient market. It posits that the market will not rely on a defendant's allegedly misleading information if the "truth" is widely disseminated during the class period and is thus known to the market. *See, e.g., Ganino v. Citizens Utility Co.*, 228 F.3d 154, 167 (2d Cir. 2000).

Indeed, *Basic* listed truth-on-the-market as one of the theories a securities law defendant may employ to

rebut the presumption of reliance in a fraud-on-the-market case:

> Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance. For example, if petitioners could show that the "market makers" were privy to the truth about [the alleged misrepresentations] and thus that the market price would not have been affected by their misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone.

Basic, 485 U.S. at 248.

It would have made little sense for the Court to discuss truth-on-the-market in connection with efforts "to rebut the presumption of reliance" if it really contemplated (as the Ninth Circuit held) that any such rebuttal must be delayed until trial. If a securities law defendant must await trial for a rebuttal opportunity, any trial victory would be of limited value – because a holding that rejects the presumption of reliance would result in decertification of the class for failure to meet Rule 23(b)(3)'s predominance requirement, not in a class-wide victory on the merits.

In concluding that materiality is not properly considered at class certification proceedings, the appeals court relied in substantial part on its conclusion that a

"no materiality" finding would defeat the claims of *every* shareholder. Pet. App. 8a. That conclusion is demonstrably mistaken. Even if the market as a whole did not rely on the alleged misrepresentations, it is entirely conceivable that individual shareholders did so; for example, they might have been unwilling to purchase shares at the market price but for their belief in the truth of misrepresentations. If such shareholders can establish loss, there is no reason why they should not be permitted to proceed with their securities fraud claims on an individual basis. Indeed, in its most recent decision regarding fraud-on-the-market claims, the Court explicitly contemplated the propriety of such individual suits:

> Reliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) cause of action. . . . The traditional (and most direct) way a plaintiff can demonstrate reliance is by showing that he was aware of a company's statement and engaged in a relevant transaction, *e.g.*, purchasing common stock – based on that specific representation. In that situation, the plaintiff plainly would have relied on the company's deceptive conduct.

Erica P. John Fund, 131 S. Ct. at 2184-85.

It would be unfair to shareholders who actually relied on the alleged misrepresentation to force them to be bound by a fraud-on-the-market class action, if there is serious doubt that "the market" also relied on the misrepresentation. *See Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 811-12 (1985). By allowing rebuttal

evidence regarding materiality to be introduced at the class certification stage, courts can protect individual shareholders who might otherwise have their rights cut off if a class were certified in a fraud-on-the-market case in which "the market" did not deem the misrepresentations to be material (in which case, the class is headed to eventual defeat).

The appeals court cited *Erica P. John Fund* in support of its contention that a plaintiff need make *only two* showings (an efficient market and public misrepresentations) to be entitled to class certification. Pet. App. 11a. The court's interpretation of the holding of *Erica P. John Fund* is questionable; that decision actually cuts in favor of Amgen's position. This Court stated that securities fraud plaintiffs must make *at least three* showings in order to obtain class certification:

> It is undisputed that securities fraud plaintiffs must prove certain things in order to invoke *Basic*'s rebuttable presumption. It is common ground, for example, that plaintiffs must demonstrate that the alleged misrepresentations were publicly known (else how would the market take them into account?), that the stock traded in an efficient market, and that *the relevant transaction took place "between the time the misrepresentations were made and the time the truth was revealed."*

Erica P. John Fund, 131 S. Ct. at 2185 (quoting *Basic*,

485 U.S. at 248 n.27) (emphasis added).[2] Accordingly, the case establishes that a key factor in determining whether the plaintiff is entitled to a presumption of reliance is "the time the truth was revealed." That is the precise issue on which Amgen has sought to be permitted to introduce rebuttal evidence; its consistent position has been that "the time that the truth was revealed" was on or before the dates on which it made its alleged misrepresentations. The panel's determination that Amgen was not permitted to introduce its rebuttal evidence at the class certification stage directly conflicts with *Erica P. John Fund*. Review is warranted to resolve that conflict.

B. The Decision Below Conflicts With *Wal-Mart's* Admonition That Courts Should Not Avoid Addressing Issues Relevant to Class Certification Simply Because They Are Also Merits-Based Issues

The Ninth Circuit held that for purposes of class certification, Rule 23 requires only that a plaintiff

---

[2] Footnote 27 of *Basic* sets forth the requirements that a plaintiff must meet in order to invoke the presumption of reliance and does so in a manner that is highly favorable to defendants opposing class certification. In an effort to explain away Footnote 27, the Ninth Circuit argued that the *Basic* footnote was merely reciting the requirements listed by the court whose judgment was under review (the Sixth Circuit). Pet. App. 11a. But by citing directly to Footnote 27 in support of the proposition that there are at least three well-established requirements that must be met to invoke the presumption of reliance, *Erica P. John Fund* undercuts the Ninth Circuit's contention that Footnote 27 sets forth the position of the Sixth Circuit, not that of the Supreme Court.

adequately plead materiality; it need not introduce supporting evidence. Pet. App. 2a ("As for the element of materiality, the plaintiff must plausibly allege – but need not prove at this juncture – that the claimed misrepresentation was material.").

That holding directly conflicts with this Court's *Wal-Mart* decision. *Wal-Mart* held:

> Rule 23 does not set forth a mere pleading standard. A party seeking class certification must affirmatively demonstrate his compliance with the Rule – that is, he must be prepared to prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc.

Wal-Mart, 131 S. Ct. at 2551 (emphasis in original).

The Ninth Circuit based its decision not to require proof of materiality at the class certification stage on the fact that "materiality is an elements of the *merits* of their securities fraud claim." Pet. App. 8a (emphasis in original). The appeals court reasoned that because materiality was (in its view) a common question of fact and could be determined on a class-wide basis, its resolution should await a trial on the merits:

> [T]he plaintiffs cannot fail to prove materiality yet still have a viable claim for which they would need to prove reliance individually. *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341 (2005). If the misrepresentations turn out to be material, then the fraud-on-the-market presumption makes the reliance issue common to the class,

> and class treatment is appropriate. But if the misrepresentations turn out to be immaterial, then *every* plaintiff's claim fails on the merits (materiality being a standalone merits element), and there would be no need for a trial on each plaintiff's individual reliance. Either way, the plaintiffs' claims stand or fall together – the critical question in the Rule 23 inquiry.

Id. at 8a-9a (citing *Wal-Mart*).

The Ninth Circuit's analysis is based on a misreading of *Wal-Mart* and indeed directly conflicts with that decision. *Wal-Mart* repeatedly emphasized that trial courts should *not* shy away from delving into issues that touch on the merits of the lawsuit, when doing so is necessary to determine whether class certification is appropriate under Rule 23. The Court explained that trial courts should engage in a "rigorous analysis" to determine whether the prerequisites of Rule 23 have been satisfied, and added:

> Frequently the "rigorous analysis" will entail some overlap with the merits of the plaintiff's underlying claim. That cannot be helped. "[T]he class determination generally involves considerations that are enmeshed in the factual and legal issues comprising the plaintiff's cause of action." . . . Nor is there anything unusual about that consequence: The necessity of touching aspects of the merits in order to resolve preliminary matters, *e.g.*, jurisdiction and venue, is a familiar feature of litigation.

Wal-Mart, 131 S. Ct. at 2551-52 (quoting *Falcon*, 459 U.S. at 160).

Moreover, the Ninth Circuit's position (that resolution of any issue that can be decided on a class-wide basis should be deferred until trial, even when the issue is relevant to class certification) has little to recommend it. It may sometimes be true that a defendant who rebuts the presumption of reliance defeats the plaintiffs' claims on the merits. But if, as the Ninth Circuit would surely concede, such a rebuttal also defeats a claim for class certification by demonstrating the absence of the predominance required by Rule 23(b)(3), what possible grounds would there be for allowing class certification to proceed? It is illogical to suggest that a court should make it easier for a plaintiff to win certification in those situations in which the defendant may have evidence demonstrating that the entire securities fraud claim is meritless.

In sum, review is warranted to resolve the conflict between the decision below and *Wal-Mart* with respect to the propriety of resolving merits-based issues in connection with class certification motions.

C. The Decision Below Conflicts With *Basic* Regarding Evidence Needed to Establish the Starting and End Dates for the Class Period

Truth-on-the-market rebuttal evidence is particularly relevant in determining appropriate starting and end dates for the class period. The trial court included within the certified class all those who

purchased Amgen stock between April 2004 and May 2007. Amgen asserts that the "truth" regarding its two biologics had entered the market by April 2004 and continued to enter the market throughout the extraordinarily lengthy three-year class period certified in this case. By denying Amgen an opportunity to submit its rebuttal evidence, both Ninth Circuit and the district court deprived themselves of crucial evidence regarding the dates, if any, on which the misleading information was affecting share prices and the dates when the "truth" effectively counterbalanced the misleading information. *See, e.g., In re Federal Nat. Mortg. Ass'n Securities, Derivatives, and "ERISA" Litigation*, 247 F.R.D. 32, 38 (D.D.C. 2008) ("whether the fraud-on-the-market presumption applies as a matter of law is essential for determining the duration of the class period").

The appeals court held that the only evidence relevant to the class certification issue is whether the market for the stock was efficient and whether the alleged misrepresentations were public. But unless a trial court agrees to hear all evidence regarding when and if the "truth" reached the market, it cannot possibly make an informed decisions regarding when the class period ought to begin and end. For example, if Amgen's excluded evidence would have shown that truth-on-the-market had eliminated the misrepresentation's effects on market price by May 2004, there can be no justification for certifying a class that runs until May 2007 simply because the plaintiff has *alleged* (but has not been asked to prove) that not until the latter date was the market fully aware of the truth. Similarly, if Amgen's evidence would have shown that the truth was

revealed by April 2004 (*i.e.*, the same date on which Respondent alleges that the misrepresentations were first made), then there can be no justification for establishing any class period – that is, class certification should be denied. By mandating exclusion of all rebuttal evidence regarding when the truth entered the market, the decision below deprives district courts of all meaningful guidance for determining an appropriate class period.

In contrast, throughout its *Basic* decision, the Court exhibited a keen awareness of the need to limit the class period to the dates during which the defendant's misstatements were distorting market price. *See, e.g.*, 485 U.S. at 249 (the presumption of reliance is rebutted, and thus class certification is inappropriate, with respect to those who traded the defendant's shares after truthful information "credibly entered the market" and "dissipated the effects of the misstatements."). Indeed, the Court expressed skepticism that a "well-developed, efficient and information-hungry market" could remain misinformed – and thus mis-appraise the value of the defendant's stock – throughout a 14-month class period as a result of a small number of statements by the defendant. *Id.* at 249 n.29. Respondent asks the federal courts to believe that the market mis-appraised Amgen stock throughout a class period that was almost three times as long (37 months). In conflict with *Basic*, the decision below prevents Amgen from introducing evidence designed to show that the class period is excessive because the market knew "the truth" for some or all of that period. Review is warranted in order to address that conflict.

II. REVIEW IS PARTICULARLY IMPORTANT BECAUSE CLASS CERTIFICATION DECISIONS ARE OFTEN OUTCOME-DETERMINATIVE

Empirical research demonstrates the crucial role that class certification decisions play in the outcome of high-stakes class action lawsuits. Litigation costs make it very difficult for the party that loses the class certification decision to continue with the litigation – with the result that erroneous certification decisions are often effectively unreviewable. In light of that concern, *amici* respectfully urge the Court to grant review for the purpose of adopting clear rules that will encourage district judges to certify plaintiff classes only after they have determined that all the requirements of Rule 23 have been satisfied.

As numerous courts have recognized, companies that face a large certified class and hence enormous potential damages are "under intense pressure to settle" *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1298 (7th Cir.) (Posner, C.J.), *cert. denied*, 516 U.S. 867 (1995). Unless they want to "roll the dice," they must settle, often without regard to the merits of the plaintiffs' claims *Id.* Such settlements can in many instances legitimately be deemed "blackmail settlements." H. Friendly, *Federal Jurisdiction: A General View* 120 (1973). *See* Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 99 (2009) ("With vanishingly rare exception, class certification sets the litigation on a path toward resolution by way of settlement, not full-fledged testing of the plaintiffs' case by trial.").

Securities fraud class action litigation presents particular problems for defendants because they are especially prone to asymmetrical discovery costs: though plaintiffs possess few relevant documents subject to discovery, they can routinely demand that millions of pages of documents be produced by the defendants. J. Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 548-49, 571 (Feb. 1991). Moreover, because securities fraud cases often require the attention and participation of senior corporate executives, defendants in such actions can face costly and debilitating disruptions of their business activities. R. Bone & D. Evans, *Class Certification and the Substantive Merits*, 51 DUKE L.J. 1251, 1299 (Feb. 2002). Driven largely by litigation costs, "the vast majority of certified [securities fraud] class actions settle, most soon after certification." *Id.* at 1291.

The tendency of securities fraud class actions to settle without any relation to the underlying merits of the suits undermines the aim of the federal securities laws: to deter securities fraud or manipulation. But economists doubt that those laws can achieve their purpose given the consensus view that there is little correlation between being named in a securities fraud lawsuit and the incidence of fraud. *See, e.g.*, M. Johnson, *et al.*, In re Silicon Graphics Inc.: *Shareholders Wealth Effects Resulting from the Interpretation of the Private Securities Litigation Reform Act's Pleading Standard*, 73 S. CAL. L. REV. 773, 782 (May 2000).

Congress has recognized the problem and has adopted legislation designed to curb abusive securities

law class actions. The Private Securities Litigation Reform Act of 1995 (PSLRA), 109 Stat. 737, adopted numerous reform measures, including a provision that imposed strict pleading requirements upon "any private action" arising from the Securities Exchange Act. *See* 15 U.S.C. § 78u-4(b). Congress enacted the PSLRA "as a check against abusive litigation by private parties." *Tellabs, Inc. v. Makor Issue & Rights, Ltd.*, 551 U.S. 308, 313 (2007). It recognized that "[p]rivate securities fraud actions, . . . if not adequately controlled, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law." *Id. See* H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.) (evidence of abuse included "routine filing of lawsuits . . . whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of [the defendants]," and "abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized [defendants] to settle"). As acknowledged by the Court, "Proponents of the [PSLRA] argued that these abuses resulted in extortionate settlements, chilled any discussion of issuers' future prospects, and deterred qualified individuals from serving on boards of directors." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006).

Review is warranted to determine whether federal courts, by certifying securities law class actions without regarding to whether the defendants' alleged misrepresentations were material and thereby affected the market, are encouraging the sorts of abuses that the PSLRA sought to discourage.

CONCLUSION

Amici curiae Washington Legal Foundation and Allied Educational Foundation request that the Court grant the petition for a writ of certiorari.

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Dated: April 4, 2012

PETITIONER'S BRIEF

RECORD AND BRIEFS

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IN THE

Supreme Court of the United States

AMGEN INC., KEVIN W. SHARER, RICHARD D. NANULA, ROGER M. PERLMUTTER, GEORGE J. MORROW,
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether, in a misrepresentation case under SEC Rule 10b-5, the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory.

2. Whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

CORPORATE DISCLOSURE STATEMENT

There are no changes to the disclosure statement included in the petition for a writ of certiorari in this case.

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CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR PETITIONERS

INTRODUCTION

To prevail in a private action alleging a misrepresentation in violation of section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, a plaintiff must prove reliance on the alleged misrepresentation. In *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), this Court recognized that securities-fraud plaintiffs could not proceed with a class action if they were required to prove each class member's direct individual reliance on the misrepresentation, because individual questions would overwhelm common ones, thereby precluding certification, *see* Fed. R. Civ. P. 23(b)(3). The Court, however, endorsed a rebuttable presumption of reliance by every

class member for cases in which the "fraud-on-the-market" theory applies. That theory states that if a security trades in an efficient market, all public *material* information is reflected in the price of the security. Purchasers or sellers who rely on the integrity of the market price therefore also rely, indirectly, on any material misrepresentation, which would be reflected in that price. The Court also held that the presumption of class-wide reliance can be rebutted by "[a]ny showing that severs the link between the alleged misrepresentation" and "the price received (or paid) by the plaintiff." *Basic*, 485 U.S. at 248.

This Court's decisions since *Basic* make clear that securities-fraud plaintiffs seeking to proceed as a class must demonstrate at the class-certification stage that certain predicates to the fraud-on-the-market theory—and thus to *Basic*'s presumption of reliance—have been satisfied. These predicates include that the market for the security is efficient, that the alleged misrepresentation was public, and that the plaintiff traded the shares "'between the time the misrepresentations were made and the time the truth was revealed.'" *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179, 2185 (2011) (hereafter *Halliburton*) (quoting *Basic*, 485 U.S. at 248 n.27). The first question presented here is whether another fraud-on-the-market predicate, the materiality of the alleged misrepresentation, must similarly be proved at class certification. The second question is whether defendants must have an opportunity, before class certification, to offer evidence rebutting the applicability of the fraud-on-the-market theory (and thus the presumption of reliance). Under Federal Rule of Civil Procedure 23 and this Court's precedent, the answer to both questions is yes.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-13a) is reported at 660 F.3d 1170. The court's order denying rehearing en banc (Pet. App. 51a-52a) is unreported, as is the opinion of the district court granting respondent's motion for class certification (Pet. App. 15a-50a).

JURISDICTION

The judgment of the court of appeals was entered on November 8, 2011. *See* Pet. App. 1a. A timely petition for rehearing en banc was denied on December 28, 2011. Pet. App. 51a-52a. The petition for a writ of certiorari was filed on March 1, 2012, and granted on June 11, 2012. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES, REGULATIONS, AND RULES INVOLVED

Pertinent portions of the following provisions are reproduced in the appendix to the petition for a writ of certiorari: Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78t(a) (Pet. App. 53a-54a); Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (Pet. App. 55a); and Federal Rule of Civil Procedure 23 (Pet. App. 56a-57a).

STATEMENT

1. Respondent Connecticut Retirement Plans and Trust Funds is the named plaintiff in this putative securities-fraud class action. Connecticut Retirement alleges that Petitioner Amgen Inc. artificially inflated the market price for Amgen stock by making misrepresentations regarding the safety of two Amgen products,

Aranesp® and Epogen®. Pet. App. 16a. Those products are erythropoiesis-stimulating agents (ESAs), which stimulate the production of red blood cells and thus reduce the need for patient transfusions. Pet. C.A. Br. 6. Connecticut Retirement alleges that Amgen made misrepresentations about: (1) the subject matter of a May 2004 advisory committee meeting of the Food and Drug Administration, (2) clinical trials involving Aranesp, (3) the safety of on-label uses of both drugs, and (4) their marketing. Pet. App. 17a-20a.

Connecticut Retirement moved to certify a class of persons who purchased Amgen stock from April 22, 2004, through May 10, 2007. Pet. App. 16a. The start of this period corresponds to a public statement by Amgen regarding the May 2004 FDA advisory committee meeting. Connecticut Retirement alleges that Amgen misrepresented that the meeting would not focus on the safety of Aranesp. Pet. App. 17a. The end of the class period corresponds with a later meeting of the same committee. Connecticut Retirement alleges that this meeting constituted a corrective disclosure, revealing information about the safety of ESAs, including Aranesp and Epogen. Pet. App. 19a.

Connecticut Retirement sought class certification pursuant to Federal Rule of Civil Procedure 23(b)(3). Pet. App. 22a. That rule conditions certification on, among other things, a finding by the district court that "questions of law or fact common to class members predominate over any questions affecting only individual members." As with most misrepresentation claims under Rule 10b-5, the predominance inquiry in this case "turn[ed] on the element of reliance." *Halliburton*, 131 S. Ct. at 2184; *see also* Pet. App. 31a-40a. Connecticut Retirement asserted that the putative class members were entitled to *Basic*'s fraud-on-the-market-based

presumption of class-wide reliance. Pet. App. 31a. In support, it submitted expert evidence to establish the efficiency of the market for Amgen stock. Pet. App. 40a. It made no evidentiary showing, however, about the materiality of Amgen's alleged misstatements. Pet. App. 33a-34a.

Amgen opposed class certification principally on the ground that Connecticut Retirement did not, and could not, establish that the alleged misrepresentations were material. Pet. App. 8a. To the contrary, Amgen showed through analyst reports and public documents that the market was aware of all the information that Connecticut Retirement claimed Amgen had concealed through alleged misrepresentations during the class period. Pet. C.A. Br. 2, 8-9. Proof of market efficiency alone, Amgen argued, without any corresponding proof of the materiality of the alleged misrepresentations, was not sufficient to invoke a presumption of class-wide reliance based on the fraud-on-the-market theory. Pet. App. 32a.

Amgen also sought to affirmatively rebut any such presumption, again by showing that the market already was "privy to the truth," *Basic*, 485 U.S. at 248, and accordingly that no alleged misrepresentation had any impact on the price of Amgen stock. Pet. App. 41a. For example, Connecticut Retirement claimed that the class period started when an Amgen executive purportedly stated, before the May 2004 FDA advisory committee meeting, that the meeting would not focus on the safety of Aranesp. Pet. App. 17a. Amgen demonstrated, however, through numerous analyst reports and public documents dated both before and after the advisory committee meeting, that analysts were well aware that the committee would discuss possible safety concerns associated with all ESAs, including Aranesp.

Pet. C.A. Br. 9-10. Those public documents included the agenda of the meeting itself, which was published in the Federal Register more than a month in advance of the meeting. Pet. App. 41a-42a. Amgen made similar showings regarding the other alleged misrepresentations. Pet. App. 42a-43a. Based on this rebuttal evidence, Amgen argued that Connecticut Retirement was not entitled to a class-wide presumption of reliance based on the fraud-on-the-market theory, and therefore could not satisfy the Rule 23(b)(3) predominance requirement. Pet. App. 32a.

2. The district court rejected Amgen's arguments and granted Connecticut Retirement's class-certification motion. Pet. App. 15a. The court held that Connecticut Retirement could invoke *Basic*'s presumption of reliance because, "to trigger" the presumption, Connecticut Retirement "need only establish that an efficient market exists." Pet. App. 40a. The court therefore refused to consider whether Connecticut Retirement had proved the materiality predicate of the fraud-on-the-market theory, *i.e.*, whether the alleged misrepresentations were in fact material. "[T]he inquiries Defendants urge the Court to make do not concern the requirements of Rule 23, but instead concern the merits of the case," the court reasoned, holding that those inquiries should be deferred until "a later stage in this proceeding." Pet. App. 38a, 40a. For the same reason, the court also refused to consider Amgen's evidence rebutting the applicability of the fraud-on-the-market theory to this case, holding that class certification "is an inappropriate time to consider [Amgen's] contentions." Pet. App. 44a.

3. The Ninth Circuit granted Amgen leave to appeal the district court's certification order, *see* Fed. R. Civ. P. 23(f), and affirmed the district court's order.

Pet. App. 6a, 13a. The court of appeals rejected Amgen's contention that Connecticut Retirement had to prove materiality at the class-certification stage. While acknowledging that Connecticut Retirement was required "to prove at the class certification stage [1] that the market for Amgen's stock was efficient and [2] that Amgen's supposed misstatements were public," the Ninth Circuit held that Connecticut Retirement did not need to "prove [3] materiality to avail [itself and the class] of the fraud-on-the-market presumption of reliance at the class certification stage." Pet. App. 9a, 12a (emphasis omitted). Rather, Connecticut Retirement had only to "allege materiality with sufficient plausibility to withstand a 12(b)(6) motion." Pet. App. 12a.

The reason for this, the Ninth Circuit stated, is that materiality is an "element of the merits of [a] securities fraud claim," Pet. App. 8a, whereas the efficient-market and public-statement predicates to the fraud-on-the-market theory, the court asserted, are not, *see* Pet. App. 9a. As a "merits issue," the court reasoned, materiality should be addressed only "at trial or by summary judgment motion." Pet. App. 13a. The court also grounded its distinction of the materiality predicate from the efficient-market and public-statement predicates on its view that, as to materiality, the arguments of Connecticut Retirement and the class "stand or fall together," rendering "the reliance issue common to the class." Pet. App. 8a, 9a. Finally, because the court of appeals concluded that materiality need not be proven for class certification, it also approved the district court's refusal to consider Amgen's rebuttal evidence on that issue. Pet. App. 12a-13a.

SUMMARY OF ARGUMENT

I. Private plaintiffs who seek to litigate securities-fraud claims on a class basis by invoking the presumption of class-wide reliance that this Court approved in *Basic Inc.* v. *Levinson* must prove—prior to class certification—that the alleged misstatement underlying their claims was material.

A. This Court in *Basic* endorsed a rebuttable presumption of class-wide reliance after recognizing that without it, private securities-fraud plaintiffs would typically be unable to proceed as a class because individual issues would predominate as to the essential element of reliance. The *Basic* presumption rests on the fraud-on-the-market theory, which states that the price of a security traded in an efficient market reflects all material information available to the market, including any material misrepresentation. Since investors may be presumed to rely on market price, class members who buy or sell during the relevant period can all be presumed to have relied indirectly on the alleged material misrepresentation.

The materiality of the alleged misstatements is a key predicate to the fraud-on-the-market theory that is central to the presumption of class-wide reliance. Because immaterial misstatements do not—by definition—affect a stock's price, there is no basis to presume that investors relied in common on immaterial misstatements when they bought or sold the stock. The *Basic* Court's repeated references to materiality in discussing the presumption, and the clear link between materiality and an effect on stock price, confirm that materiality is an essential predicate to the presumption of class-wide reliance. This Court's subsequent decisions provide further confirmation.

B. Because materiality is a predicate to the *Basic* presumption—a presumption that is needed to satisfy Rule 23's prerequisites—the rule requires that materiality be proved prior to class certification: Until materiality has been shown, class-wide issues do not "predominate."

Rule 23 created a significant exception to the traditional American model of bilateral litigation, allowing plaintiffs who satisfy the rule's requirements to transform their lawsuit by dramatically increasing the number of parties, the resources required to resolve the case, and the defendants' potential liability. Recognizing the stark and immediate consequences that flow from class certification, this Court has repeatedly held that Rule 23 requires district courts to closely scrutinize certification requests—especially requests under Rule 23(b)(3)—and to grant them only if a searching analysis reveals that all of the rule's requirements have been met.

The requirement at issue here is that common issues of law or fact predominate over individual ones. This Court has explained that in securities-fraud cases, the answer to the predominance question frequently turns on the reliance element. But the required predominance finding can be made as to reliance (and hence overall) only through the fraud-on-the-market theory. Unless that theory can properly be invoked, therefore, certification cannot be granted. The theory cannot properly be invoked, however, unless all of its predicates—including the materiality of the alleged misstatements—have first been established. This Court and others (including the court of appeals here) have recognized this logic in regard to other predicates of the *Basic* presumption, and thus concluded that they must be proved before Rule 23 will permit certification.

The same approach should be followed with the materiality predicate.

C. Allowing district courts to certify securities-fraud classes without first ensuring that all of the predicates to the fraud-on-the-market theory have been proved—and hence that the *Basic* presumption can properly be used to make the required Rule 23 predominance finding—would have harmful practical consequences. As this Court has observed, certification of a class immediately places enormous settlement pressure on defendants, often without regard to the actual merit of the plaintiffs' claims. As the Court has also observed, such settlement pressure is particularly acute in securities-fraud cases. If materiality is not tested before certification, then, it frequently never will be; the risks and costs to defendants of continuing to litigate a case will simply be too high. Defendants will thus be forced to settle many class claims without plaintiffs ever having proved one of the predicates to the theory that allows for a class action in the first place. Moreover, such a regime would waste judicial resources, forcing district courts to expend the substantial resources required to conduct class litigation before determining whether class litigation is even properly available.

D. Recent economic research provides an additional reason why the Ninth Circuit's ruling here should be reversed. The decision below allows certification of a securities-fraud class based almost entirely on a showing of market efficiency. Contrary to the *Basic* Court's apparent assumption, however, the efficiency of a market is generally not a yes-or-no question. How efficiently a market processes information—such as an alleged misstatement—depends in part on the nature of that information. Markets are typically less ef-

ficient as to abstruse information or information that has not been widely disseminated, and more efficient as to well-publicized and easy-to-understand information. Merely concluding that a market is efficient in some overall sense therefore does not demonstrate that invocation of *Basic*'s fraud-on-the-market-based presumption is appropriate as to specific statements, because overall market efficiency does not mean that the market is efficient as to that specific type of statement. The statements themselves, including their materiality, must be examined in order to make an informed decision regarding the efficiency of the market, and thus the appropriateness of invoking *Basic*'s presumption.

E. The Ninth Circuit's two grounds for refusing to require proof of materiality before certification were, first, that materiality is an element of a securities-fraud claim, and thus not suitable to examination at the certification stage, and second, that the arguments for or against the materiality of a statement are common to the class. Both of these lack merit.

To begin with, both fail to distinguish materiality from the other fraud-on-the-market predicates that concededly do have to be established before class certification. Those other predicates are equally part of the merits of a securities-fraud claim because they must be proved at trial—typically through evidence common to the class—in order for the class to prove the required element of reliance. The Ninth Circuit's first reason is also directly contrary to this Court's decision in *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541 (2011), which reaffirmed that all matters relevant to certification must be examined at the certification stage, including those that are related (even integral) to the merits of the underlying claim. The question is not whether an issue will be considered again later but whether a class

action should be allowed to proceed at all before Rule 23 has been satisfied.

II. The Court in *Basic* expressly stated that the presumption it was adopting for securities-fraud plaintiffs was rebuttable. Defendants must have an opportunity to provide such rebuttal before certification.

As the *Basic* Court explained, a successful rebuttal demonstrates that on the particular facts of a case there is no sound basis to presume common reliance by the plaintiff class. Without that presumption, plaintiffs could not proceed as a class; individual issues would predominate as to the essential element of reliance, and thus predominate overall. In other words, a successful rebuttal defeats certification. Logically, then, the appropriate time to first address whether the presumption can be rebutted is at the certification stage. It makes no sense to say that defendants must wait until after a class is certified to show that it should not have been certified to begin with. Fairness suggests the same answer: Because of the settlement pressure created by class certification, refusing to allow rebuttal evidence before certification will often deprive defendants of *any* opportunity to rebut the presumption. That would tip the scales too far in favor of securities-fraud plaintiffs, to whom the *Basic* presumption already provides a notable advantage.

Allowing defendants to challenge the presumption before certification occurs is also consistent with this Court's Rule 23 decisions. Those decisions underscore the need for district courts to conduct a rigorous inquiry before permitting certification. American courts do not conduct such inquiries through independent investigation; they hear from both sides. There is no basis to create an exception to that approach here, par-

ticularly considering the profoundly consequential nature of the certification decision.

ARGUMENT

I. SECURITIES-FRAUD PLAINTIFFS WHO SEEK TO OBTAIN CLASS CERTIFICATION BY INVOKING *BASIC*'S PRESUMPTION OF CLASS-WIDE RELIANCE MUST PROVE MATERIALITY AT THE CLASS-CERTIFICATION STAGE

A. Materiality Is An Essential Predicate To The Fraud-On-The-Market Theory And Hence To *Basic*'s Presumption Of Reliance

1. Section 10(b) of the Securities Exchange Act of 1934 prohibits the use of "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). SEC Rule 10b-5 implements section 10(b) by prohibiting, among other things, any "untrue statement of a material fact ... in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5(b)-(c).[1]

The Securities Exchange Act does not, however, "provide an express civil remedy" to private plaintiffs for violations of these provisions. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 729 (1975). In fact, this Court has repeatedly explained that Congress, in enacting the Act, did not intend to establish a private

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[1] Last year, this Court reaffirmed that a fact is material "when there is a substantial likelihood that the disclosure of the ... fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1318 (2011) (internal quotation marks omitted).

right of action. *See Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008); *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350, 359 (1991) (citing *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 196 (1976)). Private plaintiffs instead proceed under a "judicially crafted" right of action, *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Dabit*, 547 U.S. 71, 80 (2006), first recognized by this Court in *Superintendent of Insurance of New York* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971).

The elements of such a private securities-fraud claim are: "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1317 (2011) (internal quotation marks omitted). The fourth element, reliance, is "transaction causation," *Dura Pharm., Inc.* v. *Broudo*, 544 U.S. 336, 341 (2005), meaning that the alleged misstatement caused the plaintiff to enter into the securities transaction, *see id.* at 341-342; *see also Halliburton*, 131 S. Ct. at 2186 (reliance concerns the "facts surrounding the investor's decision to engage in the transaction").

This Court has stated that reliance is an "essential" component of a 10b-5 claim because it guarantees "the 'requisite causal connection between a defendant's misrepresentation and a plaintiff's injury.'" *Stoneridge*, 552 U.S. at 159 (quoting *Basic*, 485 U.S. at 243). "Requiring the plaintiff to show that he reasonably relied on the defendants' misrepresentations is [thus] a means of ... ensuring that the federal securities laws do not expose defendants to limitless liability or become trans-

formed into merely private enforcement mechanisms." *Lipton* v. *Documation, Inc.*, 734 F.2d 740, 742 (11th Cir. 1984); *accord, e.g., Wilson* v. *Comtech Telecomms. Corp.*, 648 F.2d 88, 92 (2d Cir. 1981) ("The element of reliance serves to restrict the potentially limitless thrust of rule 10b-5[.]"), *cited in Basic*, 485 U.S. at 243.

Traditionally, a plaintiff proved reliance by "showing that he was aware of a company's statement and engaged in a relevant transaction ... based on that specific misrepresentation." *Halliburton*, 131 S. Ct. at 2185. Such individual proof, however, is inconsistent with the requirements for a class action seeking to recover damages for securities fraud. Federal Rule of Civil Procedure 23(b)(3), under which Connecticut Retirement sought certification here, permits class certification only if "questions of law or fact common to class members predominate over any questions affecting only individual members." As this Court recently observed, "[w]hether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance." *Halliburton*, 131 S. Ct. at 2184. But "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would" prevent certification under Rule 23(b)(3), "since individual issues then would ... overwhelm[] the common ones." *Basic*, 485 U.S. at 242.

2. To address that perceived difficulty, this Court, in *Basic Inc.* v. *Levinson*, approved a rebuttable presumption of class-wide reliance based on the fraud-on-the-market theory. As the Court explained, according to that theory, "in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business." 485 U.S. at 241 (internal quotation marks omitted). The "available material information,"

the Court continued, includes any material public misrepresentations. *See id.* at 246. Hence, the Court concluded, because "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price[,] ... an investor's reliance on any public material misrepresentations ... may be presumed for purposes of a Rule 10b-5 action." *Id.* at 247. *Basic*'s presumption, in other words, is that all investors who traded a security in an open and developed market during the relevant period *indirectly* relied on any material public misstatements, through the investors' common reliance on the integrity of a market price that was distorted by those material misstatements. *See id.*

The Court also made clear in *Basic*, however, that the presumption was "just that," *Halliburton*, 131 S. Ct. at 2185, and that defendants may rebut the presumption by showing that *Basic*'s chain of inferences does not apply in a particular case. As the Court explained, "[a]ny showing that severs the link between the alleged misrepresentation" and "the price received (or paid) by the plaintiff" would serve to rebut the presumption. *Basic*, 485 U.S. at 248. Such rebuttal would eliminate the logical basis for presuming class-wide reliance.[2]

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[2] Three members of the Court did not participate in *Basic*. *See* 485 U.S. at 250. Thus, while Justice Blackmun's entire opinion in the case constituted "the opinion of the Court," *id.* at 226, the portion of it that addressed the presumption of reliance was joined by only three other Justices. Justice White's dissent from that portion rested on concern about the Court's foray into economic analysis, and in particular its endorsement of an untested economic theory. *See, e.g.*, *id.* at 252 (opinion concurring in part and dissenting in part) (objecting to "economic theorization by the federal courts"); *id.* at 254 ("[T]heories which underpin the fraud-on-the-market presumption ... are—in the end—nothing more than theories."); *id.* at 254-255 (similar).

3. As a review of *Basic* demonstrates, a critical link in the chain of reasoning that led to the rebuttable presumption of class-wide reliance was a showing of materiality, *i.e.*, that the alleged misrepresentations underlying the plaintiff's claim were material. The Court explained that the presumption is that persons trade "in reliance on the integrity of the price set by the market, but because of ... material misrepresentations that price [is] fraudulently depressed." *Basic*, 485 U.S. at 245. The fraud is therefore "transmitted through market price." *Id.* at 248. Without materiality, however, there is no basis to presume an effect on the market price—and therefore to presume class-wide reliance on a distorted price—even if the other fraud-on-the-market predicates are met.

The materiality of an alleged misstatement is the connection between the fraud and class-wide reliance because materiality *means* that the statement was important to the market as a whole—that is, to reasonable investors—and therefore moved the price of the stock up or down. Immaterial misrepresentations, by definition, do not affect the price of a security. *See, e.g.*, *Oran* v. *Stafford*, 226 F.3d 275, 282 (3d Cir. 2000) (Alito, J.) ("[I]n an efficient market the concept of materiality translates into information that alters the price of the firm's stock." (internal quotation marks omitted)); Dunbar & Heller, *Fraud on the Market Meets Behavioral Finance*, 31 Del. J. Corp. L. 455, 509 (2006) ("The definition of immaterial information ... is that it is already known or ... does not have a statistically significant effect on stock price in an efficient market."). Thus, the making of an immaterial misrepresentation cannot constitute a fraud on the market—or, consequently, a common fraud on investors who are presumed to rely on the integrity of the stock price set by

the market. *See, e.g.*, *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) (Alito, J.) ("[T]o the extent that information is not important to reasonable investors, it follows that its release will have a negligible effect on the stock price."). It is only the materiality of a misstatement, in other words, that allows a court to presume an effect on the "integrity" of the market price, on which investors are presumed to rely in common.

Materiality, then, in addition to being an element of a securities-fraud claim, is critical to application of the fraud-on-the-market theory, and therefore to *Basic*'s presumption of reliance. The Court in *Basic* made this link between materiality and reliance clear, stating that "[f]or purposes of accepting the presumption of reliance ..., we need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices." 485 U.S. at 246 n.24; *see also id.* at 244-245 (quoting court of appeals decisions that linked reliance to materiality). The Court reinforced the point in discussing ways that the presumption could be rebutted in a particular case. "For example," the Court stated, "if [defendants] could show that the 'market makers' were privy to the truth ..., and thus that the market price would not have been affected by their misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone." *Id.* at 248. That example speaks directly to materiality: When the market is "privy to the truth," *id.*, a misstatement is immaterial and thus does not affect the market price.

Subsequent decisions by this Court confirm materiality's status as an essential predicate of the fraud-on-

the-market theory, and consequently of *Basic*'s presumption of class-wide reliance. For example, the Court has unanimously cited *Basic* as having approved a "presum[ption] that the price of a publicly traded share reflects a *material* misrepresentation and that plaintiffs have relied upon that [material] misrepresentation." *Dura Pharm.*, 544 U.S. at 341-342 (emphasis added). Similarly, just last year the Court unanimously described "*Basic*'s fundamental premise" as being "that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction"—*i.e.*, so long as it was material (and the other fraud-on-the-market predicates are met). *Halliburton*, 131 S. Ct. at 2186.

B. Rule 23 Requires Plaintiffs To Prove Materiality At Class Certification Along With The Other Fraud-On-The-Market Predicates

Because materiality is an indispensable predicate of the fraud-on-the-market theory, and thus of *Basic*'s presumption of indirect class-wide reliance, Rule 23 requires that it—like the other fraud-on-the-market predicates—be proved before class certification.

1. "The class-action device was designed as 'an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only.'" *General Tel. Co. of Sw.* v. *Falcon*, 457 U.S. 147, 155 (1982) (quoting *Califano* v. *Yamasaki*, 442 U.S. 682, 700-701 (1979)). "In order to justify a departure from that [usual] rule," a party seeking class certification must "prove" that the requirements of Rule 23 are "*in fact*" satisfied. *Wal-Mart*, 131 S. Ct. at 2550, 2551. A district court may therefore certify a class only if it concludes, "after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied." *Id.* at 2551 (internal

quotation marks omitted). In other words, "actual, not presumed, conformance with Rule 23(a) remains ... indispensable." *General Tel. Co.*, 457 U.S. at 160. "That is equally true of Rule 23(b)." *Szabo* v. *Bridgeport Machs., Inc.*, 249 F.3d 672, 677 (7th Cir. 2001); *accord In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 33 & n.3 (2d Cir. 2006); *Newton* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 167 (3d Cir. 2001). Indeed, it is particularly important in cases—like this one—in which certification is sought under Rule 23(b)(3): This Court has noted that Rule 23(b)(3) covers "situations in which class-action treatment is not as clearly called for," and thus requires the district court to take "a close look at the case before it is accepted as a class action." *Amchem Prods., Inc.* v. *Windsor*, 521 U.S. 591, 615 (1997) (internal quotation marks omitted).

Among the reasons for requiring a "rigorous analysis" and "close look" before class certification is that a class action is orders of magnitude different from a traditional bilateral or multi-lateral lawsuit. Immediately upon the certification of a class, the scope of the litigation expands dramatically—the number of affected parties, the time and cost required, the amount at stake, and the very dynamics of the litigation. *See AT&T Mobility LLC* v. *Concepcion*, 131 S. Ct. 1740, 1752 (2011) (noting "the higher stakes of class litigation"); *cf. Stolt-Nielsen S.A.* v. *AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1776 (2010) (noting "the fundamental changes brought about by the shift from bilateral arbitration to class-action arbitration"). Moreover, the claims of the hundreds or even thousands of class members, and the correspondingly enormous potential liability of the defendant, are placed in the hands of a single jury (possibly consisting of as few as six people). *See AT&T Mobility*, 131 S. Ct. at 1752 (observing that "when dam-

ages allegedly owed to tens of thousands of potential claimants are aggregated and decided at once, the risk of an error will often become unacceptable"). While such a large-scale transformation is authorized by Rule 23 when its requirements are met, district courts must ensure that these stark and immediate effects are imposed on the parties only when all of the enumerated requirements have indeed been established.

2. The Rule 23 requirement in dispute here is predominance, *i.e.*, whether "questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). Rule 23 does not permit certification until the district court affirmatively "finds" such predominance. *Id.* But because predominance in a private securities-fraud case "often turns" on reliance, *Halliburton*, 131 S. Ct. at 2184, no predominance finding would normally be possible unless that "essential" element, *Stoneridge*, 552 U.S. at 159, is susceptible to class-wide proof. A private securities-fraud claim is inappropriate for class certification, then, absent some means of proving reliance on behalf of the class of investors.

The presumption of class-wide reliance endorsed by this Court in *Basic* provides that means, allowing a court to make the required predominance finding as to the reliance element (and thus the claims overall). But for that to occur, the predicates of the presumption must first be established. One of those is materiality, without which there can be no fraud on the market. Until materiality is proved, therefore, no sound basis exists to allow plaintiffs to invoke the presumption. And without the presumption, the class members would have to prove reliance individually, rendering it impossible for the district court to make the required predominance finding. *See Basic*, 485 U.S. at 242. That

finding cannot simply be deferred until later in the litigation. To the contrary, "[a] court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been." Fed. R. Civ. P. 23(c)(1) advisory committee notes (2003 amendments).

Although this Court's decision last year in *Erica P. John Fund, Inc.* v. *Halliburton* is not directly on point, its reasoning fully supports requiring proof of materiality before class certification. In that case, the court of appeals had held that proof of loss causation, another element of a private 10b-5 claim, was required before certification. *See Archdiocese of Milwaukee Supporting Fund, Inc.* v. *Halliburton Co.*, 597 F.3d 330, 334 (5th Cir. 2010) (subsequent history omitted). This Court unanimously rejected that view. *See Halliburton*, 131 S. Ct. at 2186. The reason it did, the Court made clear, was that loss causation is not connected to the element of reliance, and hence not logically connected to *Basic*'s rebuttable presumption of class-wide reliance. *See id.* ("Loss causation addresses a matter different from whether an investor relied on a misrepresentation[.]"). By contrast, matters that *are* logically connected to reliance—including materiality—do have to be proven at class certification. The Court also noted, in rejecting the court of appeals' view, that "[t]he term 'loss causation' does not even appear in our *Basic* opinion." *Id.* The term materiality, on the other hand, pervades *Basic*'s discussion of the presumption of reliance. *See* 485 U.S. at 241-248.

3. Requiring proof of materiality before class certification is consistent with the treatment of the other predicates of the fraud-on-the-market theory. As this Court said in *Halliburton*, "[i]t is undisputed that ... in order to invoke *Basic*'s rebuttable presumption of reli-

ance," plaintiffs must prove—before certification—(1) an efficient market, (2) a public misstatement, and (3) that the plaintiff traded between the time of the alleged misrepresentation and the time the truth was revealed. 131 S. Ct. at 2185 (citing *Basic*, 485 U.S. at 248 n.27), *cited in Wal-Mart*, 131 S. Ct. at 2552 n.6; *accord* Br. in Opp. 15. As with materiality, the need to show each of these predicates before certification is evident from the logic of *Basic*. The market must be efficient because efficiency provides the basis for "presuming that the price of a publicly traded share reflects a material misrepresentation." *Dura Pharm.*, 544 U.S. at 341-342. Similarly, the class members must have traded between the time of the misrepresentations and the time the truth was revealed, for otherwise there is no basis to assume that they relied on the market price at a time when, "because of petitioners' material misrepresentations[,] that price had been fraudulently depressed" or inflated. *Basic*, 485 U.S. at 245. Finally, the misstatements must be public because "how [else] would the market [price] take them into account?" *Halliburton*, 131 S. Ct. at 2185.

The same reasoning applies to the materiality predicate. If a misstatement is not material, there is no basis for presuming a market-price distortion upon which plaintiffs could have commonly relied, and thus the reliance question cannot be resolved for all class members "in one stroke." *Wal-Mart*, 131 S. Ct. at 2551. As with the other predicates, therefore, plaintiffs must prove that a misstatement is material before class certification.

C. If Materiality Is Not Determined Before Class Certification, It Frequently Will Not Be Considered At All

1. A long-recognized consequence of class certification is that defendants may suddenly face enormous potential liability that they cannot afford to risk. *See* Fed. R. Civ. P. 23(f) advisory committee notes (1998 amendments) ("An order granting certification ... may force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability."). Indeed, this Court and others have often noted the "risk of in terrorem settlements that class actions entail." *AT&T Mobility*, 131 S. Ct. at 1752 (internal quotation marks omitted); *see also, e.g.*, *Newton*, 259 F.3d at 192 ("[C]lass certification would place hydraulic pressure on defendants to settle."); *West* v. *Prudential Sec., Inc.*, 282 F.3d 935, 937 (7th Cir. 2002) (noting "[t]he effect of a class certification in inducing settlement to curtail the risk of large awards"); Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 99 (2009) ("With vanishingly rare exception, class certification sets the litigation on a path toward resolution by way of settlement, not full-fledged testing of the plaintiffs' case by trial."). This Court has further observed that the pressure to settle in the wake of class certification is not limited to claims that have merit. To the contrary, "[c]ertification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a *meritorious* defense." *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 476 (1978) (emphasis added); *see also Shady Grove Orthopedic Assocs.* v. *Allstate Ins. Co.*, 130 S. Ct. 1431, 1465 n.3 (2010) (dissenting opinion) ("A

court's decision to certify a class ... places pressure on the defendant to settle even unmeritorious claims.").

The danger of undue settlement pressure that class actions inevitably entail is particularly acute in private securities-fraud cases. As this Court noted decades ago, there is "widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps*, 421 U.S. at 739; *see also Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007) ("Private securities fraud actions, ... if not adequately contained, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law."). That special concern "is founded in something more substantial than the common complaint of the many defendants who would prefer avoiding lawsuits entirely to either settling them or trying them." *Blue Chip Stamps*, 421 U.S. at 740. In securities-fraud cases, "even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial." *Id.* That is because "[t]he very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Id.* It is also because the "extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies." *Stoneridge*, 552 U.S. at 163.

Empirical evidence confirms that the power of *Basic*'s presumption of reliance to "facilitate[] an extraordinary aggregation of claims" means that the "*in terrorem* power of certification" generally forces even the least risk-averse defendants to settle once a class is

certified. *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261, 267 (5th Cir. 2007), *abrogated on other grounds by Halliburton*, 131 S. Ct. 2179. According to one recent study, a verdict is reached in only about one-third of one percent of securities-fraud class actions. *See* Cornerstone Research, *Securities Class Action Filings: 2010 Year in Review* at 14 (2011). In practice, then, failing to evaluate materiality at the certification stage will usually mean that defendants are forced to settle without any testing of the materiality of the alleged misstatements—that is, without any showing that class certification was warranted in the first place.[3]

Moreover, in every case in which the alleged misstatement is not material, refusing to evaluate materiality before class certification wastes judicial resources. If the alleged misstatements underlying a plaintiff's class claim are immaterial, then the class will not be able to prove class-wide reliance in the litigation and all the costs to the legal system of proceeding on a class-wide basis are wasted. This waste is significant: According to a study by the Federal Judicial Center, "[c]ertified class action cases consume[] considerably more judge time than cases filed as class actions but

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[3] The possibility of summary judgment does not meaningfully reduce the settlement pressure created by class certification. First, materiality is an "'an inherently fact-specific finding,'" *Matrixx*, 131 S. Ct. at 1318 (quoting *Basic*, 485 U.S. at 236), involving "inferences" and "assessments [that] are peculiarly ones for the trier of fact," *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 450 (1976). Second, once a class has been certified, the risks associated with litigating a summary judgment motion to decision are also increased, and they themselves constitute a part of the settlement pressure recognized by this Court and others.

never certified." Willging et al., Fed. Judicial Ctr., *Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules* 23 (1996), *available at* http://www.fjc.gov/public/pdf.nsf/lookup/rule23.pdf/$File/rule23.pdf. In fact, the judges who were studied spent over five times as many hours on certified class actions as on putative class actions that were never certified. *Id.* at 169 tbl. 19.

2. At the petition stage, Connecticut Retirement objected (Br. in Opp. 29) that the forgoing are "naked public policy arguments" rather than "a coherent legal argument." But the very purpose of Rule 23(b)(3) is to serve such considerations as fairness. The rule itself states that before certifying a class under subparagraph (b)(3), the district court must find "that a class action is superior to other available methods for *fairly* and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b)(3) (emphasis added). Fairness of course runs to defendants as well as plaintiffs. *See Unger* v. *Amedisys Inc.*, 401 F.3d 316, 320 (5th Cir. 2005) (recognizing "the important due process concerns of both plaintiffs and defendants inherent in the certification decision"); *In re Am. Med. Sys., Inc.*, 75 F.3d 1069, 1086 (6th Cir. 1996) (vacating a certification order in part because the defendant's "due process rights were violated by the district judge's precipitous certification of the class"). It is unfair to certify a class where the likely practical result of that step is that the materiality predicate of the essential element of reliance—the element on which the requirement of predominance "often turns," *Halliburton*, 131 S. Ct. at 2184—will never be examined.

By contrast, requiring proof of materiality before class certification creates no unfairness to plaintiffs. If

such proof exists, it can be offered as readily at the certification stage as later, given district courts' authority to allow appropriate pre-certification discovery. *See* Fed. R. Civ. P. 23(c)(1) advisory committee notes (2003 amendments) ("[I]n aid of the certification decision, ... it is appropriate to conduct controlled discovery ..., limited to those aspects relevant to making the certification decision on an informed basis."); *In re Initial Pub. Offerings*, 471 F.3d at 41 (authorizing discovery at the certification stage because "the district judge must receive enough evidence, by affidavits, documents, or testimony, to be satisfied that each Rule 23 requirement has been met"). Hence, when materiality is at issue, requiring proof of it before class certification imposes no undue burden on plaintiffs. Connecticut Retirement has never contended otherwise.

This Court's precedent makes clear, moreover, that fairness and other policy considerations are particularly pertinent in the context of private securities-fraud claims. The Court has repeatedly explained that such considerations "are entitled to a good deal of weight" in identifying the boundaries of the judicially created private cause of action under the Securities Exchange Act and Rule 10b-5. *Blue Chip Stamps*, 421 U.S. at 749; *see also supra* pp. 13-14. As the Court stated nearly 40 years ago:

> [W]e are not dealing here with any private right created by the express language of § 10 (b) or of Rule 10b-5. No language in either of those provisions speaks at all to the contours of a private cause of action for their violation. ... We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited one

> way or another unless and until Congress addresses the question.

Id. at 748-749; *see also id.* at 737 ("It is ... proper that we consider ... what may be described as policy considerations when we come to flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance."). *See generally Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1104 (1991) ("[W]here a legal structure of private statutory rights has developed without clear indications of congressional intent, the contours of that structure need not be frozen absolutely when the result would be demonstrably inequitable."). Indeed, in the same case the Court cited the settlement pressure created by securities-fraud lawsuits in rejecting the plaintiff's theory of liability. *See Blue Chip Stamps*, 421 U.S. at 740.

More recently, this Court similarly noted that it was "appropriate to examine" "[t]he practical consequences of" securities-fraud plaintiffs' proposed rule regarding liability under 10b-5. *Stoneridge*, 552 U.S. at 163. The Court reasoned that the "extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies," and cited that rationale as "further reason to reject [the plaintiff's] approach." *Id.* Under this Court's relevant precedent, then, it is entirely appropriate to accord significant weight to judicial economy and to the "hydraulic pressure" to settle created by class certification—and in particular to ensure that such pressure is not brought to bear, and substantial judicial resources needlessly expended, unless the district court has made the findings required by Rule 23.

Consideration of practical and equitable factors is all the more warranted given that what is at issue here are the contours of not only a "judicially crafted" cause of action, *Merrill Lynch*, 547 U.S. at 80, but also the judicially crafted doctrine that enables securities-fraud plaintiffs to obtain class certification in appropriate cases. Rule 23 does not, of course, provide that the required predominance finding can be made via a fraud-on-the-market-based presumption of class-wide reliance. It was only the Court's approval of that presumption in *Basic* that allowed securities plaintiffs to proceed as a class in this context. There is no reason why plaintiffs should enjoy that significant judicially created advantage without satisfying the judicially stated requirements for its application. As the Fifth Circuit put it, a certification order's "bite should dictate the process that precedes it." *Oscar Private Equity*, 487 F.3d at 267.

D. Modern Economic Research Further Demonstrates Why The Ninth Circuit Should Not Have Expanded The *Basic* Presumption

Under the rule adopted by the Ninth Circuit, a court may certify a securities-fraud class based almost exclusively on a general showing of the efficiency of the trading market for the security. But proof that a market is generally efficient does not make it appropriate to apply the fraud-on-the market theory in every case involving a security in that market. Economic research, much of it post-*Basic*, demonstrates that efficiency cannot be analyzed in the abstract; whether a market is efficiently processing specific information depends on a host of factors, including the nature of the information, its source, and the other information available to investors. Proof of the materiality of an alleged

misstatement is required because it provides much of this necessary context.

The Court in *Basic* relied in part on "[then-r]ecent empirical studies" that tended to confirm the efficient-market hypothesis. 485 U.S. at 246. According to the Court, that hypothesis was straightforward: "the market price of shares traded on well-developed [*i.e.*, efficient] markets reflects all publicly available information." *Id.* The Court thus found it reasonable to presume that, so long as the market is efficient, any material misrepresentation would have an effect on the market price on which investors would rely in common. Lower courts applying *Basic* have developed various multi-factor tests to determine whether a particular market is efficient. *See, e.g.*, *Cammer* v. *Bloom*, 711 F. Supp. 1264, 1286-1287 (D.N.J. 1989) (articulating five factors); *Krogman* v. *Sterritt*, 202 F.R.D. 467, 478 (N.D. Tex. 2001) (adding three more factors); *see also Unger*, 401 F.3d at 323 (noting that the *Cammer/Krogman* factors "have been used by many courts throughout the country").

Modern economic research shows, however, that these efficiency tests do not reliably predict whether a particular piece of information will be incorporated into a security's market price. *See, e.g.*, Fisher, *Does the Efficient Market Theory Help Us Do Justice in a Time of Madness?*, 54 Emory L.J. 843, 863-868 (2005).[4]

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[4] *Accord* Erenburg et al., *The Paradox of "Fraud-on-the-Market Theory": Who Relies on the Efficiency of Market Prices?*, 8 J. Empirical Legal Stud. 260, 292 (2011) ("Overall, the *Cammer* and *Krogman* factors that we examine exhibit little relation to weak-form market efficiency."); Barber et al., *The Fraud-on-the-Market Theory and the Indicators of Common Stocks' Efficiency*, 19 J. Corp. L. 285, 305-307 (1994) (finding that three factors—the

The research casts serious doubt on a key premise underlying the *Basic* Court's endorsement of the presumption of reliance, namely that market efficiency is "a binary, yes or no question," Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 167; *see also* Cornell & Rutten, *Market Efficiency, Crashes, and Securities Litigation*, 81 Tul. L. Rev. 443, 448 (2006). That premise ignores the reality that there are differences in efficiency *within* a market. As studies have shown, a market can be efficient in some respects but not in others—efficient as to some types or sources of information but not others, for example, or efficient over some periods of time but not others. *See, e.g.*, Macey & Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 Stan. L. Rev. 1059, 1079-1091 (1990).[5]

Markets are most likely to be efficient as to information that is both widely disseminated and relatively easy to understand, such as merger announcements and public reports of stock splits. Stock prices often respond to this type of information very soon after it be-

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size of an issuer, the bid-ask spread, and institutional holdings—were not independently important efficiency indicators); Bernard et al., *Challenges to the Efficient Market Hypothesis: Limits to the Applicability of Fraud-on-the-Market Theory*, 73 Neb. L. Rev. 781, 796 (1994) (similarly finding that firm size, analyst following, and percentage of outstanding shares held by institutions did not significantly and independently predict efficiency).

[5] *See also* Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance* 2 (2000); Fox, *The Myth of the Rational Market* 200-206, 250-255, 259-262, 295-300, 312-318 (2009); Brown et al., *Analyst Recommendations, Mutual Fund Herding, and Overreaction in Stock Prices* 33-34 (Feb. 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1363837.

comes public. *See* Brealey & Myers, *Principles of Corporate Finance* 358-360 (6th ed. 2000) (describing studies); Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. Corp. L. 635, 653 (2003). In contrast, markets are less efficient when investors must expend substantial time and resources to acquire or understand the information. *See* Brealey & Myers at 363-365 (describing studies). For example, "news of a change in quarterly earnings will require a large investment in information-gathering to decode," and studies show that markets do not "respond particularly quickly to" such news. Macey & Miller, 42 Stan. L. Rev. at 1083, 1084. Even "[o]ne of the most common types of material disclosures—an earnings surprise—actually takes a while to be fully impounded, even for large-cap stocks, and even varies depending on whether it is good news or bad." Langevoort, 2009 Wis. L. Rev. at 170. Studies also have found that information already known to the market through SEC filings, like insider-trading disclosures, can have a delayed but significant price impact once publicized through prominent media outlets, probably as a result of the high costs of obtaining and processing such information earlier, before its dissemination by the media. *See* Chang & Suk, *Stock Prices and the Secondary Dissemination of Information: The Wall Street Journal's "Insider Trading Spotlight" Column*, 33 Fin. Rev. 115, 116-117 (1998).

A striking example of this phenomenon occurred in *In re Merck & Co. Securities Litigation*, 432 F.3d 261 (3d Cir. 2005). In that case, Merck, one of the largest pharmaceutical companies in the world, disclosed through a public SEC filing an accounting interpretation that had significant adverse implications for its revenues. Initially, the disclosure appeared to have no negative effect on Merck's stock price—indeed, the

price increased on each of the next five days, including the day of the filing. *Id.* at 264, 269. Two months later, however, *The Wall Street Journal* published an article analyzing the disclosure and estimating its potential significance, causing an immediate and significant decline in the market price. *See id.* at 265. In short, although "it is hard to imagine any stock more likely traded in an efficient market than Merck," Langevoort, 2009 Wis. L. Rev. at 174, a public disclosure with important revenue implications nonetheless had no meaningful price impact for more than two months—a period that might have been even longer had the media report not called attention to the disclosure.

Because market-wide efficiency tests fail to account for these common issues regarding the assimilation of information into the price of a security, it would be improvident for courts to expand the *Basic* presumption by allowing class certification under the fraud-on-the-market theory based on a finding of general market efficiency alone. A court cannot reliably conclude, based on that proof alone, that the theory will in fact apply to a particular case. Market efficiency and materiality are both essential predicates, and often are intertwined, when determining whether a presumption of class-wide reliance is appropriate. The misrepresentation at issue must have been material, and the market must have been efficient as to that misrepresentation, such that the court considering class certification can reliably say—before transforming the case into a class proceeding—that the market price incorporated the alleged misrepresentation. Allowing a presumption of reliance at class certification without any examination of the materiality of the statement itself is thus supported by neither "common sense" nor "probability." *Basic*, 485 U.S. at 246.

E. The Ninth Circuit's Grounds For Refusing To Require Proof Of Materiality Before Certification Lack Merit

The court of appeals offered two reasons for refusing to examine materiality (or to permit any rebuttal on the issue) at the class-certification stage. Neither has merit.

1. The court first noted that materiality is "an element of the merits of [a] securities fraud claim." Pet. App. 8a (emphasis omitted). Hence, the court reasoned, it should "be reached at trial or by summary judgment motion." Pet. App. 13a. By contrast, the court stated, two other predicates of the fraud-on-the-market theory—market efficiency and the public nature of the alleged misstatements—"are not elements of the merits of a securities fraud claim," and therefore are appropriately examined at the class-certification stage. Pet. App. 9a. This reasoning is flawed for at least two reasons.

First, it is contrary to this Court's decision last year in *Wal-Mart Stores, Inc.* v. *Dukes*. *Wal-Mart* held that at the certification stage, district courts must examine all issues relevant to the Rule 23 inquiry, regardless of whether those issues overlap with or are even identical to issues that must later be considered on a summary judgment motion or at trial. As the Court explained, "certification is proper only if 'the trial court is satisfied, after a rigorous analysis,'" that Rule 23's prerequisites are met. 131 S. Ct. at 2551 (quoting *General Tel. Co.*, 457 U.S. at 161). "Frequently," this Court recognized, "that 'rigorous analysis' will entail some overlap with the merits of the plaintiff's underlying claim." *Id.* But "[t]hat cannot be helped." *Id.* Class certification "'generally involves considerations

that are enmeshed in the factual and legal issues comprising the plaintiff's cause of action.'" *Id.* at 2551 (quoting *General Tel. Co.*, 457 U.S. at 160). A Rule 23 determination, in other words, must be made before, and independently of, any merits determination. The rule provides no exception for subjects that, if litigated at class certification, might reveal that the plaintiff's and the class's claims lack merit.[6]

This principle is especially relevant here, where the reason for the Rule 23 inquiry into materiality is distinct from the reason for the merits inquiry into the same issue. Rule 23 requires courts to examine materiality as a predicate to the fraud-on-the-market theory because only the applicability of that theory allows for class-wide proof on the reliance element. That a plaintiff's failure to prove materiality, a distinct element of a Rule 10b-5 claim, would defeat every plaintiff on the merits is irrelevant to whether individualized issues predominate on the distinct element of reliance.

The Court's application of the Rule 23 principles in *Wal-Mart* itself confirms the error of the Ninth Circuit's analysis here. In order to meet the Rule 23 commonality requirement, the plaintiffs in *Wal-Mart* had to show that Wal-Mart "'operated under a general policy of discrimination.'" 131 S. Ct. at 2553 (quoting *General Tel. Co.*, 457 U.S. at 159 n.15). To establish the merits element of a "pattern or practice of discrimination," they similarly had to show that "discrimination was the

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[6] Although *Wal-Mart* interpreted the commonality requirement of Rule 23(a)(2), its holdings also apply to the predominance requirement of Rule 23(b)(3), which "subsume[s]" and is "more stringent"—indeed, "far more demanding"—than Rule 23(a)(2). *Amchem*, 521 U.S. at 609, 624.

company's standard operating procedure." *Id.* at 2552 & n.7 (emphasis and internal quotation marks omitted). Notwithstanding this substantial overlap, the Court held that before certification the plaintiffs had to submit "significant proof" of a "general policy of discrimination," because of its relevance to the Rule 23 inquiry. *Id.* at 2553 (internal quotation marks omitted). The Court in *Wal-Mart* thus refused to excuse compliance with Rule 23's requirements simply because the "proof of commonality [required for class certification] necessarily overlaps with [plaintiffs'] merits contention that Wal-Mart engages in a pattern or practice of discrimination." *Id.* at 2552 (emphasis omitted). The Ninth Circuit's ruling in this case is entirely inconsistent with the lesson of *Wal-Mart*.

Second, the Ninth Circuit's logic does not distinguish materiality from the efficient-market, public-statement, and trade-timing predicates that *do* have to be proved before class certification. *See Halliburton*, 131 S. Ct. at 2185. The court of appeals asserted that these other predicates "are not elements of the merits of a securities fraud claim." Pet. App. 9a. But in a case (like this one) in which the plaintiff class proceeds on a fraud-on-the-market theory of reliance, that assertion is wrong: The other predicates are necessary components of the required element of reliance because they are essential to the fraud-on-the-market theory by which the plaintiff will prove that required element. For a securities-fraud class to prevail at trial using a fraud-on-the-market theory, in other words, it must prove—at trial—not only that the alleged misrepresentations were material but also that they were public, that the market was efficient, and that the class members traded during the relevant period. *See Wal-Mart*, 131 S. Ct. at 2552 n.6 ("To invoke [the fraud-on-the-

market] presumption, the plaintiffs seeking 23(b)(3) certification must prove that their shares were traded on an efficient market, *an issue they will surely have to prove again at trial in order to make out their case on the merits*." (emphasis added) (citation omitted)). A failure to prove any one of these predicates at trial—like a failure to prove materiality—would therefore doom the entire class's claim.

2. The Ninth Circuit's second reason for refusing to examine materiality (or permit any rebuttal evidence on the issue) before certification was that the arguments for and against a misstatement's materiality are common to the class, and therefore consideration of materiality could be deferred until summary judgment or trial. *See* Pet. App. 8a-10a; *id.* at 10a (noting that materiality "affect[s] investors alike").

At best, this puts the cart before the horse. The *first* question is whether to certify a class; a district court cannot properly answer that question "yes" without making the necessary Rule 23 findings merely because the process of answering it implicates common evidence or arguments.

And again, the Ninth Circuit's reasoning fails to distinguish materiality from the efficient-market and public-statement predicates. The arguments for and against market efficiency are also common across a putative class. Nevertheless, because of the importance of the fraud-on-the-market theory to overcoming an otherwise insuperable bar to class certification in securities-fraud cases, *see Basic*, 485 U.S. at 242, this Court and the courts of appeals (including the Ninth Circuit in this case) have made clear that market efficiency and a public statement must be proved at the certification stage. *See Halliburton*, 131 S. Ct. at 2185 (quoting *Ba-*

sic, 485 U.S. at 248); *Wal-Mart*, 131 S. Ct. at 2552 n.6; *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 631, 633 (3d Cir. 2011); *Schleicher* v. *Wendt*, 618 F.3d 679, 682, 688 (7th Cir. 2010); *Unger*, 401 F.3d at 322; Pet. App. 9a ("[T]he district court was correct to require Connecticut Retirement to prove at the class certification stage that the market for Amgen's stock was efficient and that Amgen's supposed misstatements were public."). This is so even though a successful class certification motion under Rule 23(b)(3) necessarily will prove the market-efficiency and public-statement predicates through evidence common to the class. The same approach is warranted for the materiality predicate.

The Ninth Circuit's two flawed rationales led it to conclude that at the certification stage plaintiffs merely need to "allege materiality with sufficient plausibility to withstand a 12(b)(6) motion." Pet. App. 12a. Rule 23, however, "does not set forth a mere pleading standard." *Wal-Mart*, 131 S. Ct. at 2551. It requires "[a] party seeking class certification" to "affirmatively demonstrate his compliance with" the rule by proving "in fact" that its requirements are satisfied. *Id.* (emphasis omitted). An allegation of materiality establishes at most the *possibility* that reliance will be a common issue if materiality can later be established. *See Ashcroft* v. *Iqbal*, 556 U.S. 662, 678 (2009) ("The plausibility standard is not akin to a 'probability requirement[.]'"), *cited in* Pet. App. 12a. But if the statements are actually immaterial, the fraud-on-the-market theory will be unavailable "in fact" as a method of class-wide proof. *Wal-Mart*, 131 S. Ct. at 2551 (emphasis omitted). Until the district court makes a finding as to whether the statement is material, it simply cannot determine whether the predominance requirement is satisfied. *See Halliburton*, 131 S. Ct. at 2184

(predominance in a securities-fraud case "often turns" on reliance).

II. Defendants Must Be Permitted To Rebut The Fraud-On-The-Market Theory At Class Certification

When the Court in *Basic* adopted the presumption of class-wide reliance for cases in which the fraud-on-the-market theory applies, it expressly labeled that presumption "rebuttable." 485 U.S. at 250. Last year, this Court confirmed that "the presumption was just that, and could be rebutted by appropriate evidence." *Halliburton*, 131 S. Ct. at 2185. As a matter, again, of logic, fairness, and judicial economy, defendants must be allowed to offer such "appropriate [rebuttal] evidence" at the class-certification stage.

1. The very purpose of the presumption is to enable the required Rule 23 finding of predominance, and thus certification of a class, where such a finding (and hence certification) would otherwise be impossible. *See Basic*, 485 U.S. at 242. Logically, then, "a successful rebuttal defeats certification by defeating the Rule 23(b)(3) predominance requirement." *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 485 (2d Cir. 2008) (emphasis omitted). It makes no sense to say that defendants must wait until summary judgment or trial in order to show that a class should not have been certified in the first place. The time to consider evidence regarding the certification question is the certification stage.

This case provides a good example. In the district court, Amgen sought to show that in light of all the information available to the market, the alleged Amgen misstatements could not be presumed to have altered the market price because they would not have "'signifi-

cantly altered the total mix of information made available,'" *Basic*, 485 U.S. at 232 (quoting *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976)) (other internal quotation marks omitted); *see also supra* pp. 5-6 (detailing Amgen's rebuttal evidence). As explained in *Basic*, a showing of this type breaks "the causal connection" inherent in the fraud-on-the-market-theory: "[t]he basis for finding that the fraud had been transmitted through market price [is] gone." 485 U.S. at 248.

The effect of a successful rebuttal, therefore, is the same as a plaintiff's failure to establish the efficient-market, public-statement, or materiality predicates: It eliminates the basis for presuming the existence of a price distortion on which the plaintiffs could have commonly relied. Because it defeats the possibility of class-wide reliance, it is a matter on which defendants should be allowed to introduce evidence at the class-certification stage.

Denying defendants any such opportunity would be fundamentally inequitable. Again, when this Court endorsed the presumption of class-wide reliance in *Basic*, it added a powerful weapon to plaintiffs' arsenal in securities-fraud litigation. The Court did so, however, with the express understanding that defendants would have a meaningful opportunity to rebut the presumption and thereby show that the plaintiffs in any particular case are not entitled to this advantage. *See* 485 U.S. at 248. That opportunity would not be meaningful if rebuttal were postponed until after class certification. Given the settlement pressure created by class certification in securities-fraud cases, defendants would rarely have any actual chance to present rebuttal evidence. Considerations of judicial economy reinforce the point: Requiring courts to initially hear evidence re-

garding class certification from only one side would inevitably lead to certification in some cases in which it is improper. Courts would then have to spend resources managing those large cases until evidence from both sides was finally allowed (or, of course, the case settled). Permitting prompt adversarial resolution of the certification issue would avoid such a waste of resources.

2. The Court's opinion in *Basic* does not support deferring the consideration of rebuttal evidence until after class certification. Responding in a footnote to Justice White's partial dissent, the Court in *Basic* stated in dictum that certain proof regarding market efficiency "is a matter for trial, throughout which the District Court retains the authority to amend the certification order as may be appropriate." 485 U.S. at 249 n.29 (citing Fed. R. Civ. P. 23(c)), *cited in* Pet. App. 44a. As the end of that sentence and the accompanying citation to Rule 23(c) indicate, this statement was made at a time when Rule 23 authorized "conditional" class-certification orders, allowing courts to defer difficult or complex questions until a later stage of the litigation. *See* Fed. R. Civ. P. 23(c)(1)(C) (1998). That authority was eliminated in 2003; now, "[a] court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been met." *Id.* advisory committee note (2003 amendments). This significant change counsels against giving any weight to *Basic*'s "for trial" observation.

In any event, a strict application of that dictum would prove too much. It would mean, for example, that issues like materiality could not be adjudicated at summary judgment—a position that, to Amgen's knowledge, no court has embraced. *See Rand* v. *Cullinet Software, Inc.*, 847 F. Supp. 200, 206 (D. Mass. 1994)

(*Basic*'s footnote "does not mean that it is always necessary or appropriate to have a trial to establish a truth on the market defense"); *see also In re DVI*, 639 F.3d at 637 n.20 ("Taken literally, note 29 may even appear to preclude a court from evaluating evidence presented by a defendant at class certification to demonstrate the market is inefficient. But this widespread practice is permitted even in circuits that do not allow the examination of rebuttal evidence at the class certification stage."). There is, in short, no basis to overread the footnoted dictum in *Basic*.

3. This Court's recent Rule 23 precedent reinforces the need to allow rebuttal at the class-certification stage. The Court has held that Rule 23 requires district courts to conduct a "rigorous analysis" of whether the rule's requirements are "in fact" satisfied before certifying a class. *Wal-Mart*, 131 S. Ct. at 2551 (emphasis omitted). It has also held that certification under Rule 23(b)(3) in particular requires a "close look" by district courts. *Amchem*, 521 U.S. at 615. District courts cannot comply with these mandates without giving both sides an opportunity to introduce and challenge evidence relevant to the Rule 23 requirements. *See In re Initial Pub. Offerings*, 471 F.3d at 27 (determining whether "each Rule 23 requirement is met" requires "that *all* of the evidence ... be assessed as with any other threshold issue" (emphasis added)).[7]

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[7] *See also In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 324 (3d Cir. 2008) ("Genuine disputes with respect to the Rule 23 requirements must be resolved, after considering all relevant evidence submitted by the parties."); *Weathers* v. *Peters Realty Corp.*, 499 F.2d 1197, 1200 (6th Cir. 1974) (at the certification stage, "[t]he parties should be afforded an opportunity to present evidence on the maintainability of the class action").

American courts, after all, are not independent investigators. Rather, "in Anglo-American legal practice, courts rely on the rigors of the adversarial process to reveal the true facts of a case." *Snead* v. *Barnhart*, 360 F.3d 834, 838 (8th Cir. 2004); *cf. Maryland* v. *Craig*, 497 U.S. 836, 845 (1990) ("reliability of the evidence" is ensured "by subjecting it to rigorous testing in the context of an adversary proceeding"); *Carroll* v. *President & Comm'rs of Princess Anne*, 393 U.S. 175, 183 (1968) ("The value of a judicial proceeding ... is substantially diluted where the process is ex parte, because the Court does not have available the fundamental instrument for judicial judgment: an adversary proceeding in which both parties may participate."). The notion of allowing plaintiffs to adduce evidence regarding the fraud-on-the-market predicates, while barring defendants from offering contrary evidence, is contrary to fundamental tenets of our adversarial system of justice.[8]

Recognizing this, the courts of appeals have permitted defendants to introduce evidence rebutting plaintiffs' showings on various issues critical to class certification. *See, e.g., Teamsters Local 445 Freight Div. Pension Fund* v. *Bombardier, Inc.*, 546 F.3d 196, 205-206 (2d Cir. 2008) (relying on defense expert's testimony on lack of market efficiency in fraud-on-the-market case to uphold denial of class certification); *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 322 (3d Cir. 2008) (vacating class certification order because the district court "did not confront [the defense

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[8] The rare exceptions to the adversarial approach—an ex parte temporary restraining order, for example—simply prove the rule. Class certification is not like any of those exceptions, which typically involve extreme time sensitivity.

expert's] analysis or his substantive rebuttal of [the plaintiff expert's] points"); *West*, 282 F.3d at 938 (reversing grant of class certification where the district court failed to resolve a dispute between competing experts, because failing to "choos[e] between competing perspectives" "amounts to a delegation of judicial power to the plaintiffs, who can obtain class certification just by hiring a competent expert"); *Bennett* v. *Nucor Corp.*, 656 F.3d 802, 814-815 (8th Cir. 2011) (crediting defendant employer's evidence showing absence of a general policy of discrimination in affirming denial of class certification), *cert. denied*, 132 S. Ct. 1807 & 1861 (2012). This Court itself has likewise underscored the importance of adversarial testing of Rule 23 requirements, albeit in the context of a limited-fund, mandatory-settlement class action. *See Ortiz* v. *Fibreboard Corp.*, 527 U.S. 815, 849 (1999) (certification in that context requires "findings of fact following a proceeding in which the evidence is subject to challenge"); *id.* at 849-850 ("'[T]he district court, as a matter of law, must have a fact-finding inquiry ... and allow the opponents of class certification to present evidence that a limited fund does not exist.'" (quoting *In re Bendectin Prods. Liab. Litig.*, 749 F.2d 300, 306 (6th Cir. 1984))). In contrast, neither Connecticut Retirement nor the Ninth Circuit has identified any circumstance where such a high-stakes litigation issue is resolved based on the unilateral presentation of evidence from one side, without affording the opposing party any chance to respond. There is no sound basis to create such a unique exception.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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RESPONDENT'S BRIEF

No. 11-1085

IN THE
Supreme Court of the United States

AMGEN INC., ET AL.,
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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QUESTIONS PRESENTED

1. Whether, under Federal Rule of Civil Procedure 23, proof of materiality is required for class certification in a securities fraud action predicated on the fraud-on-the-market theory, pursuant to § 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b).

2. Whether defendants, in a 1934 Act § 10(b) securities fraud action predicated on the fraud-on-the-market theory, must be allowed to present evidence at the class-certification stage rebutting the materiality of the alleged misstatements.

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INTRODUCTION

Congress authorized class actions in Federal Rule of Civil Procedure 23 so that federal courts could efficiently resolve controversies involving large numbers of similarly situated litigants in a single proceeding. Federal securities fraud class actions have long served that function, because fraudulent statements by defendants affect large numbers of investors who trade securities in efficient markets.

Both courts below rightly concluded that proof of materiality is unnecessary to certify a class under Rule 23. The materiality of a defendant's misstatement is a merits question—and indisputably a common one for the entire class. Materiality can have only one class-wide answer because it relates to the misstatement's importance to a reasonable investor. Materiality thus exemplifies the type of question amenable to class-wide resolution under Rule 23.

Proof of materiality also is unnecessary to show that reliance is a common question. The fraud-on-the-market theory recognized in *Basic Inc. v. Levinson*, 485 U.S. 224, 227 (1988), eliminates the individualized state-of-mind of each investor as a barrier to class certification. If the securities at issue were traded in an efficient market (which Amgen concedes in this case), then reliance converges with the objective, common questions of materiality and falsity. But *Basic* does not alter the fact that materiality remains a common question that need not be proved to certify a class. *See Schleicher v. Wendt*, 618 F.3d 679, 687 (7th Cir. 2010) (Easterbrook, J.).

Basic held that the presumption of reliance is rebuttable, but rebuttal is appropriate at the class-certification stage only if it would demonstrate intra-class dissimilarities that prevent "common *answers*

apt to drive the resolution of the litigation." *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551 (2011) (internal quotations omitted). Rebuttal evidence on materiality does not disprove commonality; it disproves materiality for the entire class. Rebuttal of materiality thus is not appropriate at the class-certification stage under Rule 23.

Amgen's gambit to infect class-certification motions with the common question of materiality would defeat the efficiency for federal courts in resolving securities fraud cases, to the detriment of plaintiffs and defendants alike. Lack of materiality should end the case on the merits, but refusing class certification on that basis would merely splinter a single class action into countless individual cases, because denial of class certification on materiality grounds does not have issue-preclusive effect on the materiality issue on the merits. That inefficient result harms both plaintiffs, who would face unnecessary costs associated with multiplicitous individual lawsuits, and defendants, who rely on class certification to bind all similarly situated plaintiffs and thereby avoid relitigating the same issues repeatedly.

Ultimately, Amgen concedes (at 27) that it is asking this Court to adopt "naked public policy arguments" rather than follow Rule 23. Those policy arguments ignore the fact that Congress has enacted statutory provisions to strike the proper balance between allowing class actions that hold companies and individuals accountable for their false statements and eliminating actions that might be abusive. Amgen's arguments provide no basis for this Court to displace Congress's considered policy judgments.

STATEMENT

A. Statutory And Doctrinal Background

1. Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934 ("1934 Act") in response to widespread abuses in the securities industry. To promote "honest markets," *Basic*, 485 U.S. at 230 (internal quotations omitted), 1934 Act § 10(b) broadly forbids the use of "any manipulative or deceptive device or contrivance" "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b).

Securities and Exchange Commission ("SEC") Rule 10b-5 implements § 10(b) by prohibiting "(a) . . . any device, scheme, or artifice to defraud, (b) . . . any untrue statement of a material fact or . . . omi[ssion of] . . . a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, [and] (c) . . . any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5. A private plaintiff seeking relief for a § 10(b) violation must show "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1317-18 (2011).

The reliance element of a federal securities fraud action, also called transaction causation, requires proof of a "'connection between a defendant's misrepresentation and a plaintiff's injury.'" *Erica P. John Fund, Inc. v. Halliburton*, 131 S. Ct. 2179, 2184 (2011) (quoting *Basic*, 485 U.S. at 243). One way

for plaintiffs to demonstrate reliance is to present evidence that they directly relied on misstatements to buy or sell the securities. In *Basic*, this Court reaffirmed that plaintiffs must prove reliance in a securities fraud action, rejecting the suggestion to do away with reliance as an element of a § 10(b) claim. 485 U.S. at 243. In doing so, however, the *Basic* Court embraced an alternate way for securities fraud plaintiffs to establish reliance in cases involving misrepresentations by companies in well-developed, efficient markets. The Court explained that, in modern securities markets, proof of direct reliance would "place an unnecessarily unrealistic evidentiary burden on the Rule 10b-5 plaintiff." *Id.* at 245. Rather than proving direct, personal reliance, the Court held that, "where materially misleading statements have been disseminated into an impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be presumed." *Id.* at 247 (noting that "nearly every court that ha[d] considered the proposition" had come to this conclusion).

2. As Solicitor General Fried explained in the government's *Basic* brief in supporting the fraud-on-the-market presumption: "The fraud on the market theory ... recogniz[es] the obvious, that market prices generally reflect corporate information and that investors generally rely on the integrity of the market price." Brief for the Securities and Exchange Commission as Amicus Curiae at 27, *Basic*, *supra* (No. 86-279), 1987 WL 881068 ("U.S. *Basic* Br.").[1]

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[1] *See* U.S. *Basic* Br. 18 n.20 ("The importance of accurate and complete issuer disclosure to the integrity of the securities markets cannot be overemphasized. To the extent that investors cannot rely upon the accuracy and completeness of issuer

That premise rests on a view that markets operate efficiently, which Congress accepted when it enacted the federal securities laws and which law-and-economics scholars "widely accepted" in the years leading up to *Basic*. *See Basic*, 485 U.S. at 246 (noting "Congress' premise that the market price of shares traded on well-developed markets reflects all publicly available information"); Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 Bus. Law. 1, 4 n.9 (1982) (noting that "[t]he literature on efficient capital market theory and its applications is massive and growing"); *Schleicher*, 618 F.3d at 685. Because "market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices," the reliance of an individual purchaser or seller of securities on such statements can be presumed once it is shown that the statements were made to an efficient market. *Basic*, 485 U.S. at 246 n.24.

The fraud-on-the-market presumption and its underlying economic rationales apply equally to both individual actions and class actions alleging securities fraud. *See, e.g., Black v. Finantra Capital, Inc.*, 418 F.3d 203, 209 (2d Cir. 2005). As Judge Koelsch's opinion in the first court of appeals case to accept the presumption explained, for example, "the standards of proof of [transaction] causation we have set out apply to all fraud on the market cases, individual as well as class actions. No interpretation of Rule 23 is involved." *Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975). The government made the same point in

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statements, they will be less likely to invest, thereby reducing the liquidity of the securities markets to the detriment of investors and issuers alike.").

its brief in *Basic*, which noted that "the presumption of reliance in a fraud on the market case is grounded on characteristics of the securities markets and investor behavior, as well as on policy objectives, that are equally applicable to individual and class actions." U.S. *Basic* Br. 26 n.32. As such, the fraud-on-the-market theory is not a procedural rule governing the preconditions for a class action, but rather a substantive rule of securities law construing § 10(b). *See Basic*, 485 U.S. at 243-44 ("The modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases, and *our understanding of Rule 10b-5's reliance requirement* must encompass these differences.") (emphasis added; footnote omitted).

3. Whereas *Basic* interpreted 1934 Act § 10(b) and SEC Rule 10b-5, Federal Rule of Civil Procedure 23 governs the certification of class actions, including securities fraud actions. Rule 23(a) requires as a threshold matter that (1) "the class is so numerous that joinder of all members is impracticable"; (2) "there are questions of law or fact common to the class"; (3) "the claims or defenses of the representative parties are typical of the claims or defenses of the class"; and (4) "the representative parties will fairly and adequately protect the interests of the class." Fed. R. Civ. P. 23(a). Petitioners do not contest on appeal that those threshold requirements are met in this case.

If the Rule 23(a) threshold requirements are satisfied, Rule 23(b) permits a class to be certified if (as relevant in this case) "the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to

other available methods for fairly and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b)(3). The "predominance inquiry" of Rule 23(b)(3) "tests whether proposed classes are sufficiently cohesive to warrant" class treatment. *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 623 (1997); *see also* 2 Alba Conte & Herbert B. Newberg, *Newberg on Class Actions* § 4.25, at 156 (4th ed. 2002) (the "predominance test asks whether a class suit for the unitary adjudication of common issues is economical and efficient in the context of all the issues in the suit").

What constitutes a "common question" was recently clarified by this Court in *Dukes*. There, this Court explained that "'[w]hat matters to class certification . . . is not the raising of common "questions"—even in droves—but, rather the capacity of a classwide proceeding to generate common *answers* apt to drive the resolution of the litigation.'" 131 S. Ct. at 2551 (quoting Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 132 (2009)) (emphasis by Nagareda; ellipsis in original).[2] Under *Dukes*, to satisfy Rule 23 the proposed class members' "claims must depend upon a common contention" and "[t]hat common contention, moreover, must be of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." *Id.*

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[2] Although the question in *Dukes* concerned the Rule 23(a)(2) commonality requirement, the 23(b)(3) requirement that common questions "predominate" draws on the same concept. *Cf. Dukes*, 131 S. Ct. at 2556; *see also Amchem*, 521 U.S. at 609 (Rule 23(a)(2) "subsumed under" Rule 23(b)(3) predominance requirement).

Under Rule 23, "the court must determine by order whether to certify the action as a class action" "[a]t an early practicable time." Fed. R. Civ. P. 23(c)(1)(A). However, an order granting or denying class certification "may be altered or amended" at any time "before final judgment." Fed. R. Civ. P. 23(c)(1)(C). The rule also permits interlocutory appeals from an order granting or denying certification. Fed. R. Civ. P. 23(f).

4. In 1995, Congress enacted the Private Securities Litigation Reform Act ("PSLRA") (codified as amended in various sections of Titles 15 and 18, U.S.C.) in response to concerns that certain "abusive practices committed in private securities litigation" were leading to a situation in which "innocent parties are often forced to pay exorbitant 'settlements.'" Joint Explanatory Statement of the Committee of Conference, 141 Cong. Rec. 34,753 (1995). Congress provided specific mechanisms for curbing such practices, but maintained the private class action, noting that "[p]rivate securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing." *Id.*

B. Nature Of The Action

Respondent Connecticut Retirement Plans and Trust Funds ("Connecticut")[3] brought this securities fraud class action against petitioners Amgen Inc. and four individuals who were executives at Amgen during the relevant time period (collectively, "Amgen").

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[3] The Connecticut State Treasurer is the principal fiduciary for Connecticut Retirement Plans and Trust Funds, which consists of six state pension and eight state trust funds.

The Consolidated Amended Class Action Complaint ("Complaint") was filed on October 1, 2007, on behalf of a class of purchasers of Amgen's publicly traded securities. R151 V.2 Tab 6.[4] The Complaint alleges that, between April 22, 2004, and May 10, 2007 (the "class period"), Amgen violated §§ 10(b) and 20(a) of the 1934 Act, 15 U.S.C. §§ 78j(b), 78t(a), and SEC Rule 10b-5 by knowingly or recklessly making materially misleading statements and omissions concerning two of Amgen's flagship products, Aranesp® and Epogen®. R87-88, 156-60 V.2 Tab 6.

1. *Amgen's ESA Products*

Aranesp and Epogen are in a drug class known as erythropoiesis-stimulating agents ("ESAs"). ESAs stimulate the production of red blood cells, which contain hemoglobin—a protein that transports oxygen from the lungs to the tissues of the body. R89, 97-98 V.2 Tab 6. The U.S. Food and Drug Administration ("FDA") has approved ESAs to reduce the need for transfusions in certain patients with anemia, including cancer patients with anemia associated with chemotherapy. App. 16a-17a.[5] Amgen's ESA "franchise" was critical to its fortunes, accounting for "approximately half" of all the company's revenues. R100 V.2 Tab 6.

2. *Amgen's Misrepresentations and Omissions During the Class Period*

The misrepresentations and omissions at issue primarily concern the safety of Aranesp and Epogen.

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[4] References to "R__ V.__ Tab __" are to the page, volume, and tab number of "Defendants-Appellants' Excerpts of Record" filed by Amgen in the court below.

[5] References to "App. __" are to the appendix accompanying the certiorari petition.

Both before and during the class period, a growing body of clinical trial evidence demonstrated that, when used "off-label" (for example, to achieve or maintain higher hemoglobin levels than recommended in FDA-approved ESA labeling),[6] ESAs were becoming more strongly associated with increased mortality, accelerated tumor growth in certain cancer patients, and other serious health problems. R103-05, 107-13 V.2 Tab 6.

Largely in response to this evidence, Amgen repeatedly reassured investors during the class period that evidence existed confirming that Amgen's ESAs were safe when used "on-label," i.e., in accordance with FDA labeling instructions. The Complaint alleges that these and other statements were materially misleading. On the critical issues of whether the on-label use of ESAs adversely affected patient survival or stimulated the growth of tumors, Amgen in fact had no evidence demonstrating that its ESAs were "safe." Nonetheless, Amgen deceptively and misleadingly equated the absence of definitive evidence of on-label harm with affirmative evidence of on-label safety.[7]

In 2003 and early 2004, data from two clinical studies known as BEST and ENHANCE sparked

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[6] "Off-label" means for indications, dosage forms, dose regimens, populations, or other use parameters not mentioned in the FDA-approved labeling. R90 V.2 Tab 6.

[7] Amgen is also alleged to have made actionable misrepresentations and omissions concerning the marketing, revenues, and earnings of Aranesp and Epogen (R138-44 V.2 Tab 6), but those allegations flow from Amgen's misleading statements concerning product safety. *Cf. Matrixx*, 131 S. Ct. at 1323 (statements on revenue and earnings held actionable based on underlying safety issues with defendant's "leading revenue-generating product").

concerns within the FDA over the safety of Aranesp, even though the ESAs in those studies were made by companies other than Amgen, were not approved for use in the United States, and were administered using what would be considered "off-label" treatment strategies—achieving or maintaining higher hemoglobin levels than recommended for ESAs approved for use in the United States.[8] Because of the safety concerns the BEST and ENHANCE studies raised, the FDA sought advice and recommendations concerning the safety of ESAs approved for use in the United States from its Oncologic Drugs Advisory Committee ("ODAC"), which includes leading experts in the field of oncology. R104-05 V.2 Tab 6; R2445-46, V.11 Tab 101.

On April 22, 2004, the first day of the class period, Amgen was asked about the upcoming ODAC meeting scheduled for May 4, 2004. Petitioner Morrow (then Amgen's executive vice president of global commercial operations) reassured investors: "[T]here is no [safety] signal associated with Aranesp. We've had two perspective [sic] randomized placebo controlled trials. And the safety for Aranesp has been comparable to placebo." R87, 105-06 V.2 Tab 6.

At the May 2004 ODAC meeting itself, oncology experts raised questions about the safety of Amgen's ESAs. Amgen sought to allay those concerns by

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[8] ENHANCE involved more than 350 patients with head and neck cancer. Patients who were administered Hoffmann-La Roche's ESA, Neorecormon, had substantially shorter progression-free survival and overall survival than patients receiving a placebo. BEST involved more than 900 patients with breast cancer and was stopped after only four months because of increased mortality versus placebo in patients receiving Eprex, an ESA manufactured by a Johnson & Johnson company for marketing outside the United States. R104-05 V.2 Tab 6.

announcing that it had instituted a series of five clinical trials, dubbed the "Amgen Pharmacovigilance Program," which it described as "a responsible and credible approach to definitively resolving the questions raise[d]" at the ODAC meeting. R106-07 V.2 Tab 6 (alteration in original). Those reassurances were not true, however, because Amgen had not conducted and did not plan to conduct the types of clinical trials necessary to address the FDA's concerns.

Additional troubling off-label safety data emerged from clinical study results made public in late 2006 and early 2007. R107-13 V.2 Tab 6. In response, Amgen repeatedly gave false and misleading reassurances to investors that its ESAs were safe when used on-label. R134-38 V.2 Tab 6. Indeed, as late as April 2007, less than three weeks before the end of the class period, petitioner Sharer (then Amgen's president, chief executive officer, and chairman of its board of directors) stated on a call with securities analysts that "on label our drugs are certainly safe" and "[i]t is certainly our very, very strong conviction that our products are very safe when used on label." R91, 137-38 V.2 Tab 6.

Amgen's ability to mislead the market with its on-label safety claims ended on May 10, 2007, the last day of the class period. App. 16a. On that day, the FDA held a second ODAC meeting to discuss ESA safety. Contrary to Amgen's reassuring statements of on-label safety and purportedly "responsible and credible" clinical trial program, the *absence* of evidence of on-label ESA safety prompted one ODAC member to note that "[t]he burning question is does this thing actually kill people in the doses that we think are reasonable and appropriate? *I don't see anything that has approached an answer to that ques-*

tion." R688 V.4 Tab 10 (emphasis added). An FDA official at the meeting made clear that "no completed or ongoing trial has addressed safety issues of ESAs in cancer patients with chemotherapy-associated anemia using currently approved dosing regimens in a generalizable tumor type." R129 V.2 Tab 6. Another official revealed that Amgen had failed to provide the FDA with sufficient data concerning its clinical trial program. R129-30 V.2 Tab 6.

The ODAC panel recommended that the FDA require ESA manufacturers to conduct further studies and carry stronger warnings on ESA labels. R130 V.2 Tab 6. Amgen's common stock dropped by more than 9% on May 10, 2007—compared to a decline of only 1.2% in the overall NASDAQ index. R155 V.2 Tab 6.[9]

C. District Court Proceedings

Amgen moved to dismiss the Complaint pursuant to Federal Rule of Civil Procedure 12(b)(6), attacking each of several different categories of misstatements and omissions on grounds including lack of materiality, falsity, loss causation, and scienter. The district court considered and rejected each of those grounds. *See In re Amgen Inc. Sec. Litig.*, 544 F. Supp. 2d 1009, 1024-34 (C.D. Cal. 2008). The court ordered dismissal without prejudice of claims that had

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[9] Amgen mischaracterizes (at 4) the gravamen of Connecticut's claims. This case is not about whether Amgen misled investors concerning the topic of the 2004 ODAC meeting. Amgen positioned itself as seemingly responsive to the FDA's safety concerns with its pharmacovigilance program, and it repeatedly sought to diminish the significance of any safety concerns with its "safe when used on-label" narrative. This case is about the damages that investors suffered when the 2007 ODAC meeting effectively prevented Amgen from continuing to mislead the market on ESA safety and related issues.

been brought against "outside directors" and "non-speaking officers" only, and sustained all of the claims against the company and each of the four officers who made statements about the safety and growth of Amgen's ESAs. *Id.* at 1036-37, 1038. In its Answer, Amgen admitted the allegation in the Complaint that, "[a]t all relevant times, the market for Amgen securities was an efficient market." R153 V.2 Tab 6; D. Ct. Dkt. 149.

After conducting limited discovery,[10] Connecticut moved for class certification. App. 15a. The court granted the motion after conducting a "'rigorous' . . . analysis . . . to determine whether class certification [wa]s appropriate." App. 22a. First, the court found that the four prerequisites of Rule 23(a)—numerosity, commonality, typicality, and adequacy of representation—were satisfied. App. 23a-31a. Specifically, the court noted that it was "undisputed" that Rule 23(a)(2)'s requirement of "questions of law or fact common to the class" was met. App. 24a.

The court then considered whether Connecticut had shown that "'questions of law or fact common to class members predominate over any questions affecting only individual members.'" App. 31a (quoting Fed. R. Civ. P. 23(b)(3)). To defeat Amgen's argument that individual questions of reliance predominated over common questions, Connecticut established that the fraud-on-the-market presumption

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[10] Amgen sought to limit discovery to "class certification" issues only, whereas Connecticut sought plenary merits discovery. To avoid motions practice, the parties reached an agreement that limited the applicability of Connecticut's document requests to a small group of custodians until after Connecticut's class-certification motion was decided. *See* Order and Stipulation Re Discovery and Motion Schedule (June 26, 2008) (D. Ct. Dkt. 172); R2952-53 V.13 Tab 114; R1237-40 V.6 Tab 10.

of reliance under *Basic* could be invoked on a class-wide basis because Amgen's public misstatements were made to an efficient market. App. 33a.

Amgen argued that, as a threshold to class certification, Connecticut must establish loss causation. App. 32a-33a.[11] Amgen filed more than 80 "publicly available" exhibits, R1565-75 V.8 Tab 23, and argued that the "truth" as contained therein demonstrated that "the market drops that Plaintiff relies on to establish loss causation were not caused by the revelation of any allegedly concealed information," R1350 V.7 Tab 11.[12] Pointing to these same exhibits, Amgen also sought to oppose class certification on materiality grounds, arguing that the exhibits "can adequately rebut [the fraud-on-the-market] presumption by showing that the 'truth' was known to the market." App. 40a-41a.

The court rejected Amgen's arguments and held that Connecticut had to prove that Amgen stock traded in an efficient market (a point that Amgen had conceded in its Answer), but that "[o]ther inquiries into issues such as materiality and loss causation are properly taken up at a later stage in this proceeding." App. 40a. The court reasoned that it was required to consider "evidence which goes to the

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[11] While the case was on appeal, this Court rejected in *Halliburton* the contention that a plaintiff must prove loss causation at the class-certification stage.

[12] Amgen did not articulate what standard the district court should apply in assessing its evidence. Instead, Amgen claimed to have made a "showing" that the "truth" was on the market, which, according to Amgen, caused "the burden [to] shift[] to Plaintiff" to establish loss causation. R1350 V.7 Tab 11. Amgen's "showing" did not include any expert report or analysis demonstrating that the alleged misrepresentations failed measurably to affect the market price of Amgen stock.

requirements of Rule 23 [at the class certification stage] even [if] the evidence may also relate to the underlying merits of the case," but that proof of loss causation and materiality do "not concern the requirements of Rule 23." App. 38a (internal quotations omitted; alterations in original).

Amgen did not file a motion for summary judgment on materiality, despite its belief that its truth-on-the-market exhibits "render[ed] the alleged misstatements and omissions not material as a matter of law." Defendants-Appellants' Opening Brief at 2 (9th Cir. filed Mar. 26, 2010).

D. The Court Of Appeals' Decision

The Ninth Circuit granted permission to appeal the district court's class-certification order and affirmed, rejecting Amgen's argument that materiality must be proved for class certification. Applying *Dukes*, the court held that the "critical question in the Rule 23 inquiry" is whether the plaintiffs' claims "stand or fall together"—in other words, "'the capacity of a classwide proceeding to generate common *answers* apt to drive the resolution of the litigation.'" App. 8a-9a (quoting *Dukes*, 131 S. Ct. at 2551 (quoting in turn Nagareda, *Class Certification*, 84 N.Y.U. L. Rev. at 132)) (emphasis by Nagareda).

The Court reasoned that materiality did not have to be proved at the class-certification stage because, whether the misstatements were material or immaterial, "[e]ither way, the plaintiffs' claims stand or fall together." *Id.* "If the misrepresentations turn out to be material," then they are material for the entire class in the same way "and class treatment is appropriate." App. 8a. "But if the misrepresentations turn out to be immaterial," plaintiffs' claims still generate common answers, because then "*every*

plaintiff's claim fails on the merits." *Id.* In other words, materiality does not "'affect the decisions essential under Rule 23'" because it "'affect[s] investors alike.'" App. 10a (quoting *Schleicher*, 618 F.3d at 685). Thus, proof of materiality was not required under Rule 23. *See* App. 12a. The court noted that its holding was consistent with *Basic*, which, in adopting the fraud-on-the-market presumption, did not require proof of materiality for class certification. App. 11a.

The court contrasted the materiality of the misstatements with the requirement for the fraud-on-the-market presumption that the market for the shares be efficient. If plaintiffs failed to prove market efficiency, then each plaintiff could still have a viable claim, but would have to "seek to prove reliance individually," as there would no longer be a basis for presuming that the statements affected all plaintiffs in the same way through the market price. App. 9a. The court thus held it appropriate to require proof of efficiency at the class-certification stage, to ensure that common questions predominate. *Id.* In the instant case, however, the efficiency of the market and the public nature of the alleged misstatements were uncontested. *Id.*

Finally, the court rejected Amgen's contention that it should be allowed to introduce evidence in support of its truth-on-the-market defense at the class-certification stage. The court reasoned that the truth-on-the-market defense is "a method of refuting an alleged misrepresentation's *materiality*." App. 13a. Because defeating materiality would not rebut predominance under Rule 23(b)(3), neither proof of materiality nor evidence refuting it was required at class certification. *Id.*

SUMMARY OF ARGUMENT

I.A. A suit that meets the criteria of Rule 23 may proceed as a class action. Courts are not free to impose requirements for class certification that go beyond Rule 23. The Rule 23 requirement at issue here requires that "questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). Proof of materiality at the class-certification stage is therefore only required if, absent such proof, individual questions would predominate over common ones.

Proof of materiality is not required for class certification because the immateriality of the defendant's misstatements would not demonstrate a dissimilarity among the class members leading to predominance of individual questions. Rather, the immateriality of the misstatements would affect all class members alike. Under *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), and *Basic*, the materiality standard "is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor." *TSC*, 426 U.S. at 445. That standard does not turn on any particular investor's subjective views. If the misstatement is material (or immaterial), it will be so for all investors. Proof of materiality therefore is not necessary to show that common questions predominate in a 1934 Act § 10(b) class action. Materiality is itself a "common question" capable of class-wide resolution under Rule 23 and *Dukes*.

B. Proof of materiality likewise is not required to make reliance based on the fraud-on-the-market theory a common question. Under the fraud-on-the-market theory as adopted in *Basic*, a plaintiff in an open and developed efficient market is presumed to

rely on a material misstatement through reliance on the integrity of the market price. The plaintiff need not prove individualized, direct reliance on any particular misstatement. *Basic* converts reliance from an individualized question into an objective, common question applicable to all investors who purchased a given stock in the open market.

Basic made clear that materiality in the context of the fraud-on-the-market theory has the same objective meaning as it does under § 10(b) generally. Accordingly, materiality in the fraud-on-the-market context remains a common question. Moreover, *Basic*'s core insight was that, as long as the market is efficient, the market price will reflect any material misstatements, and therefore reliance on those misstatements can be presumed via reliance on the integrity of the market price. Under this market-integrity framework, once the efficiency of the market is shown, if the statement is materially false, reliance is presumed for the entire class of investors who bought at the market price; if the statement is not materially false, then no one in the class can establish reliance via the integrity of the market price. Reliance via the integrity of the market price therefore becomes, like materiality and falsity, a common question capable of only one answer for the entire class.

Because both materiality and reliance via the integrity of the market price are common questions, not susceptible of different answers for individual class members, requiring proof of materiality for class certification goes beyond what is required by Rule 23 and this Court's Rule 23 precedents. *Basic* itself confirms that proof of materiality is not required for class certification, affirming the lower court's certifi-

cation of the class based on the fraud-on-the-market theory even while remanding the lower court's summary judgment decision on the question of materiality.

C. Requiring proof of materiality at the class-certification stage would have adverse effects on courts' ability to administer securities fraud class actions. Courts would have to consider a particularly fact-intensive issue at an early stage of the case, before full discovery. Plaintiffs would have the burden of proving materiality at this early stage under the evidentiary standard that plaintiffs would face at trial, increasing the chance that courts will fail to certify a class in situations where full discovery would reveal the materiality of the misstatements. Resolving materiality at the class-certification stage, instead of on the merits, would also deprive *defendants* of a class-wide preclusive determination of the issue and would splinter investors' claims, increasing the burden on the courts. The practical difficulties of requiring proof of materiality at the class-certification stage are not justified by Amgen's repeated invocation of the "in terrorem" effect of class certification. Congress has specifically addressed the concerns expressed by Amgen through legislative action, and there is no reason to distort Rule 23 in response to Amgen's perceived concerns.

D. Amgen incorrectly argues that proof of materiality is required to show that reliance is a common question under the fraud-on-the-market theory. Amgen's claim that absent proof of materiality courts will have to decide issues of individualized reliance is misplaced. If the misstatements are not material, then all plaintiffs' claims will fail on the merits, and there will never be any need to address individual-

ized reliance, because materiality is a precondition to liability under § 10(b) and Rule 10b-5. Moreover, Amgen's argument that a plaintiff must prove at the class-certification stage all of the elements required to show fraud on the market at the merits is clearly wrong. Indeed, Amgen's logic would suggest that plaintiffs must also prove at the class-certification stage that the statements at issue were false, but not even Amgen has suggested that such a requirement would be consistent with Rule 23.

Amgen's appeal (at 27) to "naked public policy arguments" fares no better. Congress specifically addressed Amgen's concerns but chose not to heighten the requirements for class certification of federal securities law cases. The data show that Congress's chosen solutions are working. Amgen's criticism of existing lower-court tests for measuring the efficiency of the market at the class-certification stage do not logically support artificially imposing proof of materiality as a requirement for class certification. Finally, Amgen's criticisms of the decision below are red herrings based on mischaracterizations of the appeals court's reasoning.

II.A. Evidence rebutting materiality is not required at the class-certification stage. Under Rule 23(b)(3), rebuttal evidence is warranted at the class-certification stage only if it would demonstrate that individual issues predominate. Evidence rebutting the materiality of the alleged misstatements does not negate the predominance of common questions because it does not show the existence of individualized questions. Rather, rebutting materiality defeats the claims of all class members alike.

B. Amgen's proffered "truth on the market" rebuttal evidence similarly cannot disprove predominance.

If the truth really was on the market, that cannot affect individual class members differently, such that individual questions would predominate. Rather, that would mean that *all* members of the class were not defrauded. *Basic* confirms that truth-on-the-market evidence is not appropriate for class certification.

ARGUMENT

I. PROOF OF MATERIALITY IS NOT REQUIRED AT THE CLASS-CERTIFICATION STAGE IN A FEDERAL SECURITIES FRAUD CASE

A. Under Rule 23(b)(3) And *Dukes*, Materiality Is A Common Question Not Susceptible To Different Answers For Individual Class Members

1. As this Court held just three Terms ago: "By its terms," Rule 23 "creates a categorical rule entitling a plaintiff whose suit meets the specified criteria to pursue his claim as a class action." *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 1437 (2010); *see also Amchem*, 521 U.S. at 620 (explaining that Rule 23 sets out "requirements the[] [courts] are bound to enforce"). Rule 23 authorizes a party to maintain a class action if the Rule 23(a) prerequisites are satisfied and, as relevant here, "the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). Because Amgen does not contest that Rule 23(a)'s requirements are met, it can prevail only if it shows that proof of materiality is necessary to show that common questions predominate over individual ones.

Notwithstanding Amgen's lengthy policy arguments against securities fraud class actions, courts are not free to impose additional prerequisites to class certification beyond the requirements of Rule 23. *See In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 317-18 (3d Cir. 2008) (concluding that *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), precludes "a merits inquiry that is not necessary to determine a Rule 23 requirement"); *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 41 (2006) ("in making such [certification] determinations, a district judge should not assess any aspect of the merits unrelated to a Rule 23 requirement"), *clarified on reh'g denial*, 483 F.3d 70 (2d Cir. 2007).

This Court's recent decision in *Dukes* reaffirms that principle. *Dukes* explained that the lower court committed error by refusing to consider certain issues that pertain to the Rule 23 inquiry simply because they overlapped with the merits; similarly, it also is error for a court to demand proof at the class-certification stage on merits issues that do not overlap with the Rule 23 inquiry. *See* 131 S. Ct. at 2551-52 (citing, *inter alia*, *Szabo v. Bridgeport Machs., Inc.*, 249 F.3d 672, 676-77 (7th Cir. 2001) (Easterbrook, J.)); *see also Schleicher*, 618 F.3d at 685 ("Although we concluded in *Szabo* . . . that a court may take a peek at the merits before certifying a class, *Szabo* insisted that this peek be limited to those aspects of the merits that affect the decisions essential under Rule 23."); *infra* pp. 30-31.

2. Materiality is not necessary to show predominance in a Rule 23(b)(3) class action. "The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor."

TSC, 426 U.S. at 445. Specifically, materiality turns on whether a "'reasonable investor'" would view the misstatement or omission at issue as altering the "'total mix'" of available information. *Matrixx*, 131 S. Ct. at 1318 (quoting *Basic*, 485 U.S. at 231-32). Materiality thus trains on the objective importance of the misstatements (or omissions) made by the defendant to the reasonable investor. *See TSC*, 426 U.S. at 450. It does not relate to the characteristics of any particular investor or to any particular investor's subjective views about the importance of the information. *See Matrixx*, 131 S. Ct. at 1318 (courts view materiality through lens of a "'reasonable investor'") (quoting *Basic*, 485 U.S. at 231-32).

Under these well-settled precedents, materiality in a § 10(b) class action is inherently a "common question" for the class rather than a question "affecting only individual members." Fed. R. Civ. P. 23(b)(3).[13] This Court so held in *Basic*: "This case required resolution of several common questions of law and fact concerning the falsity or misleading nature of the three public statements made by Basic, the presence or absence of scienter, *and the materiality of the misrepresentations, if any*." 485 U.S. at 242 (emphasis added). That unequivocal holding in *Basic* is itself sufficient to dispose of this case: any dispute over materiality is irrelevant to class certification because materiality is a common question, not a question that affects individual members differently.

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[13] *See, e.g.*, 7A Charles Alan Wright et al., *Federal Practice and Procedure* § 1763, at 234 (3d ed. 2005) (in a securities fraud suit, "the required common questions relate to the existence, materiality, and type of false statements that have been made"); *Korn v. Franchard Corp.*, 456 F.2d 1206, 1212 (2d Cir. 1972) ("The existence and materiality of these misrepresentations undoubtedly present significant common questions.").

Moreover, as a matter of first principles under Rule 23, *Basic*'s holding is correct. Because the materiality of a misstatement (or omission) is measured by the objective "reasonable investor" standard, by definition it cannot differ from one class member to another. If the misstatement (or omission) at issue is material, it will be material for the entire class in the same exact way. Likewise, if it is immaterial, the misstatement (or omission) will be immaterial in the same exact way for the entire class. Materiality is therefore a quintessential "common contention . . . capable of classwide resolution" where "determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." *Dukes*, 131 S. Ct. at 2551.

In that respect, materiality is no different from the falsity of the statements at issue, which *Basic* and numerous other courts have recognized as a paradigmatic common question that need not be decided at class certification. *See Basic*, 485 U.S. at 242; *Schleicher*, 618 F.3d at 685; *cf. Escott v. Barchris Constr. Corp.*, 340 F.2d 731, 733 (2d Cir. 1965) ("The theoretical possibility of having to try that issue thirty-five hundred times . . . demonstrate[s] the desirability of providing for a representative action in which the issue of falsity need be tried only once."). Materiality, like falsity, relates to the nature of the statement (or omission) made by the defendant, not to any act or characteristic of any individual investor. Materiality is also no different from scienter: just as there is only one possible answer to whether the defendant made a particular misstatement with the necessary fraudulent intent, there is only one possible answer to the question whether a misstatement altered the total mix of information to a reasonable

investor. Thus, like falsity and scienter, "materiality affect[s] investors alike." *Schleicher*, 618 F.3d at 685.

A failure to prove materiality is an example of what Professor Nagareda has described as a fatal *similarity* that defeats the claims for the entire class, and thus is appropriately addressed not at the class-certification stage but at summary judgment or trial. *See* Nagareda, *Class Certification*, 84 N.Y.U. L. Rev. at 107; *see also id.* at 131 (what "really matters" at the class-certification stage is "dissimilarity that has the capacity to undercut the prospects for joint resolution," whereas "the question of whether the class exhibits some fatal similarity—a failure of proof as to all class members on an element of their cause of action—is properly engaged as a matter of summary judgment").[14] Under Rule 23(b)(3), therefore, materiality is inherently a common question and plaintiffs need not prove it to establish predominance in a § 10(b) class action.

B. The Fraud-On-The-Market Theory Does Not Require Proof Of Materiality For Class Certification

Proof of materiality also is not required to make reliance a common question under Rule 23. *Basic* made clear that materiality in the context of the fraud-on-the-market theory has the same meaning as when it is considered as an independent element of a

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[14] Accordingly, securities fraud cases are routinely viewed as exemplars of when the predominance requirement of Rule 23 is met. *See Amchem*, 521 U.S. at 625 ("Predominance is a test readily met in certain cases alleging consumer or securities fraud or violations of the antitrust laws."); *see also Schleicher*, 618 F.3d at 682 ("[w]hen a company's stock trades in a large and efficient market, . . . common questions predominate and class certification is routine").

§ 10(b) claim. *See* 485 U.S. at 248 n.27. As explained above, materiality is inherently an objective question that yields a single answer for the entire class. Whether a statement is material for purposes of proving fraud on the market therefore is a common question to be adjudicated on a class-wide basis. Indeed, this Court in *Halliburton* did not mention materiality among the elements that a plaintiff must show "to invoke *Basic*'s rebuttable presumption of reliance" at the class-certification stage. 131 S. Ct. at 2185. Like the element of loss causation, which this Court in *Halliburton* held is not a prerequisite to class certification in a securities fraud case, proof of materiality is not required to show that common questions predominate. The reasoning and result in *Basic* and *Halliburton*, as well as this Court's recent Rule 23 decisions, all support affirmance.

1. In *Basic*, this Court recognized that reliance in the context of modern securities markets stems from the "integrity of the price set by the market" rather than the traditional conception of direct reliance on a particular piece of information. 485 U.S. at 245. "An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price." *Id.* at 247. As the Court stated, "it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?" *Id.* at 246-47 (internal quotations omitted).

As *Basic* pointed out, this understanding of reliance under § 10(b) is necessary to account for the fundamental differences between impersonal securities markets and traditional face-to-face transactions contemplated by common-law fraud cases. *See id.* at 244. Quoting Judge Higginbotham's decision in *In re LTV Securities Litigation*, 88 F.R.D. 134 (N.D. Tex.

1980), the Court stated: "'In face-to-face transactions, the inquiry into an investor's reliance upon information is into the subjective pricing of that information by that investor.'" 485 U.S. at 244 (quoting 88 F.R.D. at 143). In contrast, "'[w]ith the presence of a market, the market is interposed between seller and buyer and, ideally, transmits information to the investor in the processed form of a market price.'" *Id.* (quoting 88 F.R.D. at 143).

In short, *Basic*'s key holding was that, if the market in a security is "open and developed," any investor that bought at the market price is presumed to have relied on any misrepresentation that impaired the integrity of the market price—even absent specific evidence that the investor knew of or relied on the particular misrepresentation. *See id.* at 241-42 ("Misleading statements will . . . defraud purchasers of stock even if the purchasers do not directly rely on the misstatements.") (internal quotations omitted). That insight from *Basic* creates an alternative to the individualized question typical of reliance in fraud cases and provides a path for resolving the reliance element based on the common, objective question whether the misstatement impaired the integrity of the market price for securities traded in an efficient market.

2. "[I]n an open and developed securities market, the price of a company's stock is determined by the available *material* information regarding the company and its business." *Basic*, 485 U.S. at 241 (internal quotations omitted; emphasis added); *see also id.* at 244 ("the dissemination of material misrepresentations or withholding of material information typically affects the price of the stock, and purchasers generally rely on the price of the stock as a reflection of its value") (internal quotations omitted).

Thus, under *Basic*'s market-integrity framework for proving reliance, once a plaintiff-investor shows that the defendant's statement was made to an efficient market, the question of reliance will be resolved by the answers to purely objective, common questions. If the statement is materially false, then reliance is presumed because material false statements affect the integrity of the market price at which investors bought or sold the stock. *See id.* at 247. If the statement is not materially false, then no one in the class can establish reliance via the integrity of the market. *See Schleicher*, 618 F.3d at 682 (once the plaintiff establishes that the defendant's statements are made to an efficient market, "the contestable elements of the Rule 10b-5 claim reduce to falsehood, scienter, materiality, and loss"); William B. Rubenstein, *A Transactional Model of Adjudication*, 89 Geo. L.J. 371, 392 (2001) ("In sum, fraud-on-the-market enables certification by turning common-law individual issues into market-based common issues, leaving for adjudicative resolution only the shared question of whether the misstatement was material."). And, because materiality (like falsity) is a common question capable of only a single answer for all investors, once an efficient market is shown, reliance via the integrity of the market price is a "common contention . . . capable of classwide resolution." *Dukes*, 131 S. Ct. at 2551.

3. Amgen's attempt to add proof of materiality as an additional precondition to class certification contravenes this Court's recent Rule 23 precedents. Amgen's erroneous position is akin to the error that this Court corrected in *Dukes*. As Professor Nagareda explained, the Ninth Circuit in *Dukes* had "underreache[d]" in "declining to decide whether class

members are relevantly the same." Richard A. Nagareda, *Common Answers for Class Certification*, 63 Vand. L. Rev. En Banc 149, 168 (2010). "Elsewhere, however, other courts have *overreached* by engaging in the posture of class certification matters appropriately decided on a motion for summary judgment. That, however, is simply the flip side of the error [by the Ninth Circuit] in *Dukes*." *Id.* (emphasis added).

Amgen's position exemplifies that second kind of "overreaching" error. The question of materiality necessarily affects all investors equally. It therefore presents a classic "situation[] in which the dispute is not over whether the members of the proposed class are relevantly the same or relevantly different but, instead, over whether they are the same in such a way as to indicate that *all* class members should lose on the merits." *Id.* And, once an efficient market is shown, reliance also becomes a common question that turns on the materiality of the false statement. Thus, on the question whether the false statement was material for purposes of the fraud-on-the-market presumption, "the proper mode of judicial analysis is summary judgment, not class certification." *Id.* at 169.

Basic itself also confirms that understanding. The Court in *Basic* vacated the lower courts' rulings on materiality, holding resolution of that issue to be a matter for summary judgment or trial. *See* 485 U.S. at 240-41. Significantly, this Court simultaneously *affirmed* the district court's order certifying the class. *See id.* at 250. Thus, this Court did not regard proof of materiality as a necessary precondition to class certification under the fraud-on-the-market framework. If Amgen's understanding of the law were correct, this Court would have vacated and remanded

the class-certification order for further consideration along with the question of materiality. In sum, this Court's securities law and class-action cases converge to demonstrate that proof of materiality is not required to certify a § 10(b) class action under Rule 23.

C. Requiring Proof Of Materiality For Class Certification Will Have Adverse Effects And Is Unnecessary

1. Requiring proof of materiality is not only contrary to Rule 23 and this Court's decisions, but such a requirement would impair the judicial administration of securities fraud class actions. Materiality is both an objective standard, *see supra* pp. 23-24, and a highly fact-intensive one. As this Court has stated, the materiality "determination requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him"—assessments that are "peculiarly . . . for the trier of fact." *TSC*, 426 U.S. at 450.

This Court also has rejected as necessarily overinclusive or underinclusive various efforts to reduce materiality to a simplistic, single-variable inquiry. *See Basic*, 485 U.S. at 236 ("Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive."); *see also Matrixx*, 131 S. Ct. at 1318-19 (reiterating this Court's rejection of "bright-line" rules for materiality).[15] Amgen's suggestion,

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[15] Although *Basic* held that material misstatements affect the integrity of the market price, that by no means suggests that price impact is the only way to determine materiality. This Court's decisions emphatically reject any such simplistic, single-variable test for materiality. *See, e.g.*, *Matrixx*, 131 S. Ct. at

therefore, unnecessarily places courts in the difficult position of having to resolve an especially nuanced and fact-intensive issue at an early stage of litigation.[16]

Amgen's proposal also subverts the proper evidentiary standards for securities class actions. Some courts that have addressed this question believe that a preponderance-of-the-evidence standard attaches to facts supporting Rule 23 requirements.[17] That proposed standard is far higher than the standard for demonstrating the existence of a genuine issue of material fact sufficient to defeat a motion for summary judgment.[18] Amgen's position would require

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1318-19. Rather, "[p]roof that a misrepresentation or omission is material may be offered in a variety of ways." 1 Louis Loss et al., *Fundamentals of Securities Regulation* 791 (6th ed. 2011) ("Loss, *Fundamentals*"); *see also Matrixx*, 131 S. Ct. at 1322-23 (materiality adequately alleged based on information provided to defendant from medical experts regarding Matrixx's leading product); *infra* pp. 35-36 & nn.22-24 (discussing cases finding materiality from several non-price impact methods).

[16] In its petition, Amgen contended that its "rebuttal evidence disproved materiality" by establishing "that no alleged misrepresentation had any impact on the price of Amgen stock." Pet. 5, 17. In other words, its CEO's statement that "on label our drugs are certainly safe," while not inherently immaterial, was rendered so because of other information available to investors. By Amgen's logic, its allegedly false statements about the safety of one of its most important products did not themselves have the capacity to alter the "total mix" of information; rather, those false statements were neutralized by other information in the "total mix" available to reasonable investors.

[17] *See, e.g.*, *Hydrogen Peroxide Antitrust Litig.*, 552 F.3d at 320; *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, 546 F.3d 196, 202 (2d Cir. 2008).

[18] *See* Fed. R. Civ. P. 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

plaintiffs to satisfy the standard that plaintiffs would face *at trial*, before discovery is even completed. Amgen offers no support from this Court's cases for imposing that heightened evidentiary obligation on investors seeking to proceed as a class.

Despite that extreme position, Amgen itself concedes (at 26 n.3) that materiality is so fact-intensive that it is difficult to resolve even at summary judgment. *See also TSC*, 426 U.S. at 450 n.12 (noting that "the jury's unique competence in applying the 'reasonable man' standard is thought ordinarily to preclude summary judgment" on materiality).[19] Amgen's recognition of the fact-intensive nature of the materiality inquiry at summary judgment belies its contention (at 27-28) that proving materiality at the class-certification stage "creates no unfairness to plaintiffs" because, "[i]f such proof exists, it can be offered as readily at the certification stage as later." Indeed, Amgen fails to offer any insight regarding how plaintiffs should demonstrate materiality at the class-certification stage.

Amgen's position also ignores the well-established mechanisms for resolving issues such as materiality prior to trial. Although materiality is often a fact-intensive inquiry, courts have ample tools to weed out cases involving false statements that are obviously immaterial as a matter of law at an earlier stage. *See, e.g., Indiana State Dist. Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935, 944 (6th Cir. 2009) ("Courts have

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[19] If materiality is often too fact-intensive for resolution at summary judgment, after full discovery, then requiring courts to consider this issue at the class-certification stage, with even less discovery and with a higher burden on plaintiffs, is illogical and one-sided.

consistently found immaterial a certain kind of rosy affirmation commonly heard from corporate managers and numbingly familiar to the marketplace—loosely optimistic statements that are so vague, so lacking in specificity, or so clearly constituting the opinions of the speaker, that no reasonable investor could find them important.") (internal quotations omitted); 15 U.S.C. § 78u-5(c)(1)(A)(i) (providing safe harbor for forward-looking statements accompanied by meaningful cautionary statements).

Worse yet, Amgen's position also would substantially increase the burdens on federal courts. The core purpose behind Rule 23 is to "save[] the resources of both the courts and the parties by permitting an issue potentially affecting every [class member] to be litigated in an economical fashion under Rule 23." *General Tel. Co. v. Falcon*, 457 U.S. 147, 155 (1982) (internal quotations omitted; second alteration in original). Materiality is an issue that should have a single answer for all investors. But because class-certification decisions do not have issue-preclusive effect on the merits for any class members,[20] resolving materiality against plaintiffs at the class-certification stage would not dispose of *any* of plaintiffs' claims; it would merely splinter them into separate claims by individual investors.

For example, Connecticut and every other large investor that had losses significant enough to be worth pursuing on an individual basis would still be able to pursue the very same allegations against Amgen through individual § 10(b) lawsuits. These suits presumably would be brought in different

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[20] *See Dukes*, 131 S. Ct. at 2552 n.6 (plaintiffs must prove efficiency of market for class certification and again at trial on the merits).

courts across the country, depending on where each institutional investor was located. Denying certification would lead to the very real prospect of inconsistent jury verdicts on a question that should have a single, consistent answer. Perversely, that result harms *defendants* in securities class actions by eliminating the preclusive effect of a judgment in their favor on materiality as to the entire class.[21]

2. Requiring plaintiffs to prove materiality at the class-certification stage also imposes unwarranted barriers to the enforcement of the securities laws because materiality is so highly fact-intensive that it is extremely difficult to prove without the benefit of full merits discovery. For example, a defendant's own records often contain powerful evidence that the defendant itself viewed the statements as material.[22]

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[21] Amgen's argument (at 26-27) that failure to decide materiality at the class-certification stage "wastes judicial resources" gets it exactly backward. A certified class action may consume more judicial resources than an individual, non-class lawsuit, but the relevant point is that a single class action is more economical than hundreds of individual lawsuits. Thus, certification of a class does not waste judicial resources in cases where the evidence later shows that "the alleged misstatements underlying a plaintiff's class claim are immaterial" (*id.* at 26); certification saves judicial resources by allowing a single court to resolve the entire class's claim on the merits in a single action. The Multi-District Litigation ("MDL") process would not be a superior alternative in this context, given the requirement that the transferee court transfer back cases for trial after pre-trial procedures. *See Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26 (1998). Because, as Amgen acknowledges, disputed issues of fact often cause summary judgment to be inappropriate for materiality, the MDL court would be obliged to transfer most cases back to the transferor court for trial.

[22] *See Basic*, 485 U.S. at 239 (materiality of merger discussions depends in part on "indicia of interest in the transaction at the highest corporate levels" and "by way of example . . .

Moreover, proof of materiality often requires third-party discovery—for example, from brokers and other market participants that can offer testimony about the importance of the statement to a reasonable investor.[23] And materiality often requires expert evidence.[24] Absent the opportunity to conduct comprehensive merits discovery, plaintiffs would be deprived of key tools critical to proving materiality.[25] Amgen's position thus creates a significant risk that courts will fail to certify federal securities fraud class actions even in cases where the evidence after full discovery would show that the misstatements were material.

That result is wholly inconsistent with the core policies behind the federal securities laws. This Court

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board resolutions, instructions to investment bankers, and actual negotiations between principals or their intermediaries may serve as indicia of interest"); *cf. United States v. Rajaratnam*, 802 F. Supp. 2d 491, 498, 508 (S.D.N.Y. 2011) (finding sufficient evidence of materiality based in part on wiretapped call between defendant and his brother).

[23] *See Weiner v. Quaker Oats Co.*, No. 98 C 3123, 2000 WL 1700136, at *12 (N.D. Ill. Nov. 13, 2000) (noting expectation of testimony at trial from "a securities analyst, mutual fund manager, or other expert on the importance of the leverage ratio figure to a reasonable investor's assessment of corporate health").

[24] *See* 1 Loss, *Fundamentals* 795; *In re Control Data Corp. Sec. Litig.*, 933 F.2d 616, 620 n.10 (8th Cir. 1991) ("There was expert testimony in the record indicating that disclosure of the risk of loan default would be important to investors. Thus, the plaintiffs should be allowed to test that claim before a jury.").

[25] Proof of materiality is thus not the simple matter that Amgen's *amici* suggest. *See also* Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 187 ("[E]vent studies . . . simply do not produce clean results when there are two or more simultaneous issuer-specific events being measured over a short time horizon.").

repeatedly has recognized that private securities claims are "an essential supplement to criminal prosecutions and civil enforcement actions." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007); *see also Basic*, 485 U.S. at 231 (private cause of action for violation of § 10(b) and Rule 10b-5 "constitutes an essential tool for enforcement of the 1934 Act's requirements"); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (noting that this Court has "repeatedly ... emphasized that implied private actions [under Rule 10b-5] provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to [SEC] action'") (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)).

Because securities violations often create small-dollar damages for a multitude of investors, the securities laws would often go unenforced or under-enforced if private class actions were unduly restricted. *See* X Louis Loss & Joel Seligman, *Securities Regulation* 4625-26 (3d ed. rev. 2005) ("The ultimate effectiveness of the federal remedies ... may depend in large measure on the applicability of the class action device.") (internal quotations omitted; ellipsis in original); *see also Amchem*, 521 U.S. at 617 ("The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights.") (internal quotations omitted). Imposing an unduly high burden on plaintiffs seeking to certify class actions thus undermines the federal securities laws by creating the risk that millions of small investors—especially ordinary individuals whose losses are too small to

support individual actions—will be deprived of the ability to vindicate their claims.

There is no workable solution to this problem that does not undermine another core purpose of Rule 23, which is to provide clarity as to which parties will be bound by the proceedings "[a]t an early practicable time." Fed. R. Civ. P. 23(c)(1)(A). Deferring the class-certification decision until after full merits discovery would mean that the parties and the court would not know whether the proceeding was an individual or a class proceeding until a very late stage of the litigation. Alternatively, conducting a two-phase proceeding—one phase involving discovery and trial on materiality and a separate phase involving discovery and trial on other merits issues such as falsity and scienter—would unnecessarily prolong every federal securities class action for courts and parties.

In sum, turning a pure *merits* issue into a *class-certification* question not only violates Rule 23, but also creates serious practical difficulties. Those difficulties will tax the lower federal courts, create unfairness to both defendants and plaintiffs, and undermine Congress's intent.

3. Amgen argues that all of these adverse consequences are required to avoid the "in terrorem" effects of class actions. But requiring materiality to be proved at the class-certification stage is not a justifiable solution to that perceived problem because Congress has specifically addressed it through other means. Amgen and its *amici* ignore the fact that the PSLRA was enacted explicitly in response to the concern that "extortionate 'settlements'" were being "extracted" from companies. Joint Explanatory Statement of the Committee of Conference, 141 Cong. Rec. 34,753 (1995). Both the House and Senate committee reports, while recognizing the importance of pri-

vate actions in providing compensation for victims of securities fraud and in deterring fraudulent conduct, *see* S. Rep. No. 104-98, at 8 (1995); H.R. Rep. No. 104-50, pt. 1, at 14 (1995), explained that the PSLRA was enacted to eliminate the abusive practices that had led to this perceived in terrorem effect. *See* S. Rep. No. 104-98, at 7 (Senate bill "includes several provisions to reduce the settlement value of frivolous securities class actions"); H.R. Rep. No. 104-50, pt. 1, at 18 ("Perhaps the most offensive fact about strike suits is that studies show that a very large percentage of securities fraud class action suits settle and that the average investor recovers pennies on the dollar.").

Specifically, Congress raised the pleading standard for scienter, created an automatic stay of discovery before a motion to dismiss, provided lead-plaintiff provisions that would result in large institutional investors controlling the litigation in a responsible manner, and required courts to consider whether plaintiffs' lawyers' claims were sanctionable. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81-82 (2006). And, in the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), Congress sought to ensure that securities fraud class litigation occurs in federal court under the standards governed by the PSLRA. *See id.* at 82. These changes raised the bar for plaintiffs pleading a securities fraud action, directly addressed the issue of the cost of discovery, and effectively dealt with the perceived abuses of securities class actions.

At the same time, Congress was cognizant of the benefits of private litigation and rejected efforts that would have blocked the effective prosecution of well-pleaded meritorious actions. The PSLRA, for example, did not undo *Basic*'s presumption of reliance

based on the fraud-on-the-market doctrine, despite Congress being specifically "urged to do so by politicians and lobbyists pushing an aggressive reform package." Langevoort, *Basic at Twenty*, 2009 Wis. L. Rev. at 153; *see also, e.g.*, *Common Sense Legal Reform Act: Hearings on H.R. 10 Before the Subcomm. on Telecomms. and Finance of the H. Comm. on Commerce*, 104th Cong. 92 (1995) ("*H.R. 10 Hearings*") (statement of Dennis W. Bakke, President and CEO of AES Corporation) (advocating for direct-reliance requirement "as opposed to the fraud on the market theory"); *id.* at 251-52 (statement of John F. Olson, Washington counsel to the Corporate Governance Task Force of The Business Roundtable) (advocating rejection of the fraud-on-the-market theory, which is "simply unfair"); *id.* at 272 (statement of Daniel L. Goelzer on behalf of the Securities Industry Association) (expressing support for provision of initial House bill that would require actual direct reliance).[26] The changes that Congress did enact in the PSLRA, moreover, have sufficiently ameliorated the policy objections raised by Amgen. *See infra* pp. 43-47. Given that Congress has specifically addressed these policy concerns, there is no

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[26] The initial bill introduced, H.R. 10, 104th Cong. (1st Sess. 1995), "would have undone *Basic*." Langevoort, *Basic at Twenty*, 2009 Wis. L. Rev. at 153 n.8. The then-Chairman of the SEC, Arthur Levitt, testified before Congress that "H.R. 10 would effectively eliminate the fraud-on-the-market theory by requiring that each plaintiff prove that he or she had actual knowledge of and actually relied on a misstatement or omission in connection with the purchase or sale of stock" and "would also make it virtually impossible for investors to assert their claims as part of a class action," and that "overturning" *Basic* "would have a detrimental effect on our disclosure system, a system that has led to fair and efficient markets in our country." *H.R. 10 Hearings* at 203-04.

basis for this Court to alter Rule 23 to create additional, artificial roadblocks to the certification of securities fraud class actions.

D. Amgen's Arguments Distort The Fraud-On-The-Market Presumption And Rule 23, Rely On Unpersuasive Policy Arguments, And Mischaracterize The Decision Below

1. Amgen's argument boils down to the following: "If a misstatement is not material, there is no basis for presuming a market-price distortion upon which plaintiffs could have commonly relied, and thus the reliance question cannot be resolved for all class members 'in one stroke.'" Amgen Br. 23 (quoting *Dukes*, 131 S. Ct. at 2551). That analysis is contrary to the logic of *Basic*. Under *Basic*, if the market in Amgen stock is efficient (a point Amgen concedes), the integrity of the market price will be impaired by—and investors presumed to rely on—any materially false statement. It is not necessary for plaintiffs to prove materiality to show that reliance can be answered in a class-wide fashion. Rather, resolution of the materiality question in a fraud-on-the-market case will resolve the reliance question for all class members "in one stroke."

Amgen also argues that, at the class-certification stage, plaintiffs must prove all of the elements necessary to establish fraud on the market on the merits, including materiality. Absent such proof, Amgen asserts (at 21), questions of individualized reliance predominate. That analysis also is flawed under Rule 23, because failure to prove materiality on the merits would not mean that "class members would have to prove reliance individually." *Id.*

First, because materiality is a separate, independent element of plaintiffs' cause of action, the claims

of the entire class will fail on the merits if the defendant's misstatements were immaterial. The immateriality of the defendant's misstatements thus would never leave the court with the need to resolve the individualized issues of reliance for any class member. Amgen is incorrect to assert as "irrelevant" to the Rule 23 analysis (at 36) that plaintiffs must prove materiality as a distinct element of their claim. Such a requirement is central to the Rule 23 inquiry, because it eliminates any possibility that failure to prove materiality would result in individual issues predominating over common ones.

Moreover, Amgen's argument mischaracterizes the nature of Connecticut's claims. Connecticut here seeks certification of a class consisting of all purchasers of Amgen stock during the relevant period, excluding company insiders; the class is not limited to those that directly relied on Amgen's misstatements. R151-52 V.2 Tab 6. Proof that the market in Amgen stock is efficient (a point Amgen concedes) is sufficient to demonstrate that the question of reliance is common to the class, because all class members can demonstrate reliance by proving on the merits that Amgen's material misstatements impaired the integrity of the market price. Thus, even focusing solely on the question of reliance, proof of materiality is not necessary to demonstrate that common issues predominate over individual questions.

To the extent Amgen suggests (at 19) that *Basic* held that materiality is a "predicate" for certification of a class that seeks to proceed under the fraud-on-the-market presumption, that suggestion is unpersuasive. When the Court in *Basic* discussed the factors the court of appeals had required for the fraud-on-the-market theory, including materiality,

see Basic, 485 U.S. at 248 n.27, the Court described these factors as what was required for "proving [the plaintiffs'] loss" on the merits, *id.* at 248 (internal quotations omitted), not requirements for class certification. Nowhere did *Basic* suggest that it was requiring proof of materiality as a prerequisite for class certification. *See Schleicher*, 618 F.3d at 687 ("the Justices [in *Basic*] did not adopt [materiality] as a precondition to class certification"). To the contrary, the Court's disposition in *Basic* demonstrates that it did *not* view proof of materiality as a precondition to class certification. *See supra* pp. 31-32. Similarly, not even Amgen suggests that plaintiffs must prove the falsity of the defendant's statement at the class-certification stage, even though *Basic* described the existence of "public *misrepresentations*" as one of the factors the court of appeals had required. 485 U.S. at 248 n.27 (emphasis added).

2. Amgen devotes most of its brief to what it concedes are "naked public policy arguments" for imposing a materiality precondition to class certification in securities fraud cases (Br. 27). Even if such policy arguments were relevant, none of them is persuasive.

a. Amgen's primary argument is the tired and out-dated mantra by defendants that class certification must be curbed because it creates irresistible settlement pressures. *See* Br. 10, 20, 24-30. But that policy argument should be directed to Congress, which has twice addressed it by electing "to require more at the pleading stage and to ensure that litigation occurs in federal court under these special standards, rather than state court under looser ones." *Schleicher*, 618 F.3d at 686. Congress chose *not* to alter the rules for certification of federal securities class actions, and this Court should not do so uni-

laterally in the face of that congressional choice. *See id.* ("We do not think it appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits."); *In re Cavanaugh*, 306 F.3d 726, 738-39 (9th Cir. 2002) ("Although Congress made several important changes in the [PSLRA], it pointedly did not change the requirements of Rule 23."); *see also supra* pp. 22-23 (explaining that Rule 23 does not permit courts to alter its requirements based on perceived unfairness to defendants).

Even if Amgen's policy arguments were relevant in this forum, they are misplaced. The assertion that class certification breeds rampant settlements of meritless actions is dubious generally[27] and contradicted by empirical data in the context of federal securities class actions. In 2011, there were only 188 federal securities class-action filings out of 289,252 civil lawsuits filed in federal courts.[28] And there

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[27] *See, e.g.*, Charles Silver, *"We're Scared to Death": Class Certification and Blackmail*, 78 N.Y.U. L. Rev. 1357, 1357 (2003) (factual assertions such as "the claim that class actions always settle or that risk aversion drives the decision to settle on the defense side" are "questionable or unproven"); John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1536 n.5 (2006) ("The true 'strike suit' nuisance action, filed only because it was too expensive to defend, is, in this author's judgment, a beast like the unicorn, more discussed than directly observed.").

[28] *See* Stanford Law School Securities Class Action Clearinghouse & Cornerstone Research, *Securities Class Actions Filings: 2012 Mid-Year Assessment* 3 & Fig. 3 (2012), *available at* http://securities.stanford.edu/clearinghouse_research/2012_YIR/Cornerstone_Research_Securities_Class_Action_Filings_2012_MYR.pdf; Admin. Office of the United States Courts, *2011*

were only 65 class-action settlements approved in 2011.[29] The data simply do not support the idea that the courts are inundated with securities class-action filings and settlements.

The data also do not support the idea that these settlements are for exorbitant amounts. The median amount of the settlements in 2011 was only $5.8 million.[30] And, "[d]espite the publicity that often accompanies mega-settlements, more than half of post-[PSLRA] cases have settled for less than $10 million .... Approximately 80 percent of post-[PSLRA] cases have settled for less than $25 million, and only 7 percent of cases have settled for $100 million or higher."[31]

It also is not the case that all securities class actions end in settlement. More than one-third of securities class actions filed in the year 2000 (all of which have reached resolution by now) resulted in dismissal, not settlement.[32] For securities class actions filed in 2005 (almost 97% of which had reached

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Annual Report of the Director: Judicial Business of the United States Courts 9 (2012), *available at* http://www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2011/JudicialBusiness2011.pdf.

[29] *See* Stanford Law School Securities Class Action Clearinghouse & Cornerstone Research, *Securities Class Actions Settlements: 2011 Review and Analysis* 2 (2012), *available at* http://securities.stanford.edu/Settlements/REVIEW_1995-2011/Settlements_Through_12_2011.pdf.

[30] *See id.*

[31] *Id.* at 4.

[32] *See* Jordan Milev et al., NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2011 Year-End Review* 13 & Fig. 16 (Dec. 14, 2011), *available at* http://www.nera.com/nera-files/PUB_Trends_Year-End_1211_final.pdf.

resolution), nearly half ended in dismissal.[33] Those data strongly demonstrate that the PSLRA and the SLUSA are achieving Congress's goal of minimizing any strike suits while permitting meritorious cases to proceed. Further, the failure to proceed to trial is not unique to class actions but is a feature of all civil litigation. *See* Marc Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts*, 1 J. Empirical Legal Stud. 459, 461 (2004) (finding that the percentage of federal civil cases resolved by trial fell from 11.5% in 1962 to 1.8% in 2002); Marc Galanter, *The Hundred-Year Decline of Trials and the Thirty Years War*, 57 Stan. L. Rev. 1255, 1260 (2005) ("The recent decline has been precipitous in the federal courts, where the number of civil trials fell by two-thirds from a high of 12,570 in 1985 to 4206 in 2003.").

In a similar vein, Amgen also argues (at 26-27) that "[i]t is unfair" to certify a class where the likely result is that materiality "will never be examined" on the merits due to settlement. To the extent this argument rests on the premise that class actions force defendants to settle meritless cases, it is belied by the data. In any event, as this Court's decision in *Halliburton* makes clear, the argument proves far too much. Halliburton repeatedly argued that proof of loss causation should be required for class certification because of the "*in terrorem* effect of class certification."[34] Yet this Court squarely held that such proof is not required for class certification. 131 S. Ct. at 2183. Indeed, the exact same argument could be made with respect to *any* of the elements of a 1934

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[33] *See id.*

[34] Brief for Respondents at 2, *Halliburton*, *supra* (No. 09-1403), 2011 WL 1149040; *see also id.* at 12, 14.

Act § 10(b) claim. But Rule 23 surely does not allow courts to require plaintiffs to prove the merits of their entire claim at the class-certification stage, simply because of a concern that defendants may settle without testing plaintiffs' claims on the merits.

b. Amgen also argues that materiality must be proved for class certification because post-*Basic* research about the efficient-capital-markets hypothesis ("ECMH") supposedly shows that information presented to the market in easier-to-understand form may be absorbed more quickly than if "investors must expend substantial time and resources to acquire or understand the information." Br. 33.[35] Amgen contends that lower courts' various multi-factor tests for market efficiency "fail to account for these common issues regarding the assimilation of information into the price of a security." Br. 34; *see* Br. 31 (citing the so-called *Cammer/Krogman* factors).[36]

Even assuming Amgen's concerns were well-founded, they do nothing to support Amgen's position in this case. If the lower courts' existing tests for market efficiency are, in Amgen's view, inadequate to capture certain nuances of the efficient-capital-markets hypothesis, the solution is to revise the test for market efficiency. But Amgen conceded the issue of market efficiency in the courts below without asserting any of these concerns. And it never sought

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[35] For example, news buried in the fine print of an SEC filing may be absorbed into the market price less quickly than news highlighted in a press release. *See In re Merck & Co. Sec. Litig.*, 432 F.3d 261, 269-70 (3d Cir. 2005).

[36] *Cammer v. Bloom*, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989); *Krogman v. Sterritt*, 202 F.R.D. 467, 478 (N.D. Tex. 2001).

review by this Court of the market-efficiency standard. Having thoroughly waived the issue, it cannot be heard now to complain that the tests applied by the lower courts are inadequate. *See Sprietsma v. Mercury Marine*, 537 U.S. 51, 56 n.4 (2002).

More fundamentally, Amgen provides no explanation why requiring proof of materiality would solve these concerns. Whether a communication is clear or opaque has no bearing on whether the substance of the information contained in that communication —once understood—would affect the total mix of information available to a reasonable investor. Requiring proof of materiality thus would not address the concern whether the information in question (material or immaterial) was rapidly absorbed into the market price because of the manner in which it was communicated. In short, Amgen's concerns about the varying rates at which different types of communications may be factored into the market price are irrelevant to the questions presented in this case.[37]

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[37] To the extent Amgen is arguing that the fraud-on-the-market theory for demonstrating reliance is no longer valid, that question is not before the Court. And, even if it was, much of the scholarship Amgen cites in fact recognizes that the semi-strong form of the efficient-capital-markets hypothesis—the form underlying the fraud-on-the-market presumption adopted in *Basic*, *see Schleicher*, 618 F.3d at 685—still enjoys strong empirical support. *See, e.g.*, Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 Stan. L. Rev. 1059, 1078 n.100 (1990) (noting that "there is substantial empirical support for the weak and semi-strong forms of the ECMH"); Langevoort, *Basic at Twenty*, 2009 Wis. L. Rev. at 175 & n.109 (observing that, "[a]lthough researchers debate whether some observed anomalies are such that profitable trading strategies can be devised from them, any such strategies are usually only margin-

3. Finally, Amgen's criticisms of the court below are simply red herrings based on mischaracterizations. Amgen erroneously claims (at 35) that the court of appeals held that materiality need not be proved for class certification simply because materiality is a "merits" issue. The Ninth Circuit never said that courts are precluded from looking at merits issues at the class-certification stage. Rather, the court of appeals held that materiality need not be proved for class certification because it is a *common* question capable of generating a common answer, not merely because it is a merits question. As the court below stated, whether the statement is material or immaterial, "[e]ither way, the plaintiffs' claims stand or fall together." App. 8a-9a. As discussed above, that conclusion faithfully adhered to this Court's decisions in *Basic*, *Shady Grove*, and *Dukes*.

Amgen also argues (at 38) that the court of appeals' logic was flawed because it does not distinguish materiality from market efficiency, which the court held does have to be proved for class certification. Again, however, that simply mischaracterizes the decision below. As the court of appeals explained, it is sensible to require proof of market efficiency at the class-certification stage because such proof is necessary to demonstrate that the economic conditions for the fraud-on-the-market presumption are present.

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ally profitable, short-lived, or both," and noting that "Professor Fischel emphasized this in arguing that doubts about efficiency should not undermine the *Basic* presumption"); Victor L. Bernard et al., *Challenges to the Efficient Market Hypothesis: Limits to the Applicability of Fraud-on-the-Market Theory*, 73 Neb. L. Rev. 781, 792 (1994) ("[E]ven in light of the recent challenges to market efficiency, reliance on [the fraud-on-the-market theory] still appears justified for the large stocks comprising the majority of listings on the major exchanges.").

App. 9a. Once those conditions are established, however, the class as a whole can prove reliance on the merits by demonstrating that the defendant's statements were materially false and therefore impaired the integrity of the market price. Once efficiency is shown, proof of materiality is not required for class certification, because either way the class's claims "stand or fall together." App. 8a-9a.

II. REBUTTAL EVIDENCE REGARDING MATERIALITY IS NOT APPROPRIATE AT THE CLASS-CERTIFICATION STAGE

Amgen sought to offer evidence at the class-certification stage that the "truth" was known to the market in an effort to rebut loss causation and materiality. While the case was on appeal, this Court in *Halliburton* held that proof of loss causation was not necessary for class certification. As for materiality, the court of appeals concluded that, because (1) Amgen's truth-on-the-market defense was an effort to rebut materiality, and (2) materiality was not necessary to be proved at the class-certification stage under Rule 23, Amgen's rebuttal evidence on the issue of materiality should be considered at the merits stage, not at the class-certification stage. *See supra* p. 17.[38] Amgen does not contest the first premise of the court's reasoning;[39] and the second

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[38] Contrary to Amgen's claims (at 40-45), the lower courts did not hold that rebuttal of the presumption is never permissible at the class-certification stage. Instead, they addressed only the particular "truth on the market" defense that Amgen offered.

[39] *See* Pet. 17 ("This petition squarely presents for this Court's review both the question whether the materiality predicate must be examined at the class certification stage and the question whether it may be rebutted at the same stage."); *id.* ("Among Amgen's principal defenses to class certification w[as]

premise is correct for the reasons set forth in Part I. The court of appeals' conclusion on this issue thus should be affirmed.

A. Rebuttal Of Materiality Is Inappropriate Because It Would Not Demonstrate A Lack Of Predominance Under Rule 23(b)(3)

Any evidence rebutting predominance at the class-certification stage must address whether "questions affecting only individual members" would predominate over questions common to the class. Fed. R. Civ. P. 23(b)(3). Thus, rebuttal evidence can be appropriate at the class-certification stage only if it would negate the existence of a fact necessary to establish predominance of common questions under Rule 23(b)(3).

Amgen does not dispute this point, citing *In re Salomon Analyst Metromedia Litigation*, 544 F.3d 474 (2d Cir. 2008), for the proposition that "'a successful rebuttal defeats certification by defeating the Rule 23(b)(3) predominance requirement.'" Br. 40 (quoting 544 F.3d at 485). A recent Second Circuit case interpreting *Salomon* further explains that rebuttal is appropriate at the class-certification stage only where such evidence "could demonstrate that individual reliance issues would render a trial unmanageable, thereby defeating the predominance requirement." *In re American Int'l Group, Inc. Sec. Litig.*, 689 F.3d 229, 242 (2d Cir. 2012).

Under that standard, rebuttal of materiality is not relevant at the class-certification stage. As discussed above, *see supra* pp. 22-31, 41-43, disproving materiality would not demonstrate the existence of indi-

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its argument[] . . . that rebuttal evidence disproved materiality.").

vidual questions; it would negate the elements of materiality and reliance for all class members alike. Because materiality is an objective inquiry relating to the capacity of the defendant's misstatement to affect the decisions of a reasonable investor, rebuttal evidence showing that certain statements are immaterial would necessarily affect everyone in the class. Such rebuttal evidence cannot disprove predominance.

B. Amgen's Attempted Truth-On-The-Market Defense Is Irrelevant At The Class-Certification Stage

The particular type of rebuttal that Amgen offered in this case—a so-called "truth on the market" defense—cannot disprove predominance, and thus is irrelevant at the class-certification stage. Rebuttal of that kind does not actually rebut the fraud-on-the-market presumption of reliance:

> In the . . . situation where the market price is not artificially inflated because the truth becomes known from other sources, it is inaccurate to suggest that the presumption of reliance is rebutted. In fact, the example has nothing to do with reliance. Investors do not rely any less on the market price because that price has not been artificially inflated. It would be more accurate to characterize this situation as one where no fraud on the market occurred.

Daniel R. Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 Cornell L. Rev. 907, 918-19 (1989). *See also* Langevoort, *Basic at Twenty*, 2009 Wis. L. Rev. at 162 (explaining that "truth on the market" defense is an assertion that there was no fraud at all, because the market was privy to the truth and therefore "has in fact not been deceived"). Thus, truth-on-the-market evidence

does not establish the existence of individual issues; it proves that no one in the class was defrauded. It is thus fodder for merits motions and is not appropriate rebuttal at the class-certification stage.[40]

Amgen incorrectly contends (at 40-45) that, without the ability to present truth-on-the-market evidence, defendants have no ability to challenge or rebut the application of the fraud-on-the-market presumption at the class-certification stage. To the extent the proffered evidence has the possibility to demonstrate that the class lacks cohesion, it may be appropriate at the class-certification stage. Defendants have successfully opposed the application of the presumption at the class-certification stage by, for example, demonstrating that the relevant market is not efficient or that the statements were not made publicly. *See, e.g., Initial Pub. Offerings Sec. Litig.*, 471 F.3d at 42-43 (denying class certification because market was not efficient); *West v. Prudential Sec., Inc.*, 282 F.3d 935, 938 (7th Cir. 2002) (denying class certification when alleged fraud involved non-public statements). Rebuttal through the truth-on-the-market defense, however, is inappropriate because such evidence does not have the capacity to show the existence of indi-

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[40] Like materiality, the question whether the truth was on the market "is intensely fact-specific." *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 167 (2d Cir. 2000). The "truth on the market" defense requires the defendant to show not only that it made corrective disclosures but that those disclosures were conveyed to the public "with a degree of intensity and credibility sufficient to effectively counter-balance any misleading impression created by" the misstatements. *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1116 (9th Cir. 1989); *accord Ganino*, 228 F.3d at 167.

vidual issues that could predominate and defeat class certification.[41]

Basic confirms that truth-on-the-market rebuttal evidence is not appropriate at the class-certification stage. *Basic* affirmed the lower courts' class-certification order, notwithstanding the Court's remand for further proceedings on the issue of materiality. *See supra* pp. 30-31. That disposition would not have been appropriate had the Court thought truth-on-the-market rebuttal evidence, used to show that the alleged misstatements did not significantly alter the "total mix" of information (Br. 40-41), was relevant to class certification.

Moreover, *Basic* explicitly stated that truth-on-the-market defenses should be addressed at trial. The Court gave examples of ways that defendants may "sever[] the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price," including if defendants could show that the "market makers" were "privy to the truth" and thus that the market price would not have been affected by the misrepresentations, or if other news credibly entered the market and "dissipated the effects of the misstatements." 485 U.S. at 248-49. After discussing these two hypotheticals—which raise truth-on-the-market type defenses—the Court noted that "[p]roof of that sort is a matter for trial." *Id.* at 249 n.29. Thus, *Basic* confirms what Rule 23 already makes clear: truth-on-the-market rebuttal evidence does not concern whether a case should be certified as a class action.

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[41] Of course, defendants will have the opportunity to rebut the application of the fraud-on-the-market presumption, including via a "truth on the market" defense, at the merits stage.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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September 20, 2012

REPLY BRIEF

No. 11-1085

IN THE

Supreme Court of the United States

AMGEN INC., KEVIN W. SHARER, RICHARD D. NANULA, ROGER M. PERLMUTTER, GEORGE J. MORROW,
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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CORPORATE DISCLOSURE STATEMENT

There are no changes to the disclosure statement included in the petition for a writ of certiorari in this case.

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ARGUMENT

I. PROOF OF MATERIALITY IS REQUIRED TO CERTIFY A CLASS UNDER FEDERAL RULE OF CIVIL PROCEDURE 23(b)(3)

To obtain class certification under Rule 23(b)(3) in a securities-fraud case, the plaintiff must show that reliance can be proved on a classwide basis. *See Basic Inc.* v. *Levinson*, 485 U.S. 224, 242 (1988). One way to satisfy this burden is by "establish[ing] the applicability of the so-called 'fraud on the market' presumption." *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541, 2552 n.6 (2011); *see also Erica P. John Fund, Inc.* v. *Hallibur-*

ton Co., 131 S. Ct. 2179, 2185 (2011). As this Court's cases make clear, and as respondent and the government acknowledge, materiality is one of several essential predicates to the fraud-on-the-market theory. *See* Pet. Br. 17-19 (citing cases); Resp. Br. 29 ("If the statement is not materially false, then no one in the class can establish reliance via the integrity of the market."); U.S. Br. 23 ("[I]f a plaintiff cannot ultimately prove materiality, the plaintiff will not be able to establish reliance through the fraud-on-the-market presumption."). And "[i]t is common ground," as respondent and the government also concede, that securities-fraud plaintiffs must establish other predicates to the theory—market efficiency and a public misstatement—at the class-certification stage. *Halliburton*, 131 S. Ct. at 2185 (citing *Basic*, 485 U.S. at 248); *accord Wal-Mart*, 131 S. Ct. at 2552 n.6 (citing *Halliburton*, 131 S. Ct. at 2185); Resp. Br. 49-50; U.S. Br. 14-15, 17-18.

Accordingly, the answer to the first question presented here should be straightforward: A securities-fraud plaintiff seeking class certification under the fraud-on-the-market-theory must prove materiality before class certification because materiality is a predicate to that theory and therefore to the necessary showing that reliance can be established on a classwide basis. The contrary arguments offered by respondent and the government lack merit.

A. Predominance Cannot Be Found Without Proof Of The Materiality Predicate

1. Rule 23(b)(3) permits class certification only if the district court "finds that the questions of law or fact common to class members predominate over any questions affecting only individual members." Respondent and the government argue that a district court may

skip the determination of one of the predicate facts needed to establish that reliance is a common issue: materiality. The reason, they assert, is that the plaintiff must prove materiality *after* class certification, and if that proof fails, and hence reliance turns out to be an individual question, the class will nevertheless be united on its death bed by failure to prove the materiality element. *See* Resp. Br. 29, 41-42; U.S. Br. 8, 9-10, 13-14, 18-19 & n.3.

This response disregards both the text of Rule 23 and its purpose, which is to assure that there is a cohesive class *before* the parties and the court are required to embark on a class proceeding. A would-be class plaintiff has no right to litigate any issue on the merits on behalf of a class—much less lose it—unless the district court first evaluates the putative class members' claims as they exist at the time of the class-certification inquiry and concludes that the common issues presented by those claims predominate over the individual ones. In a securities-fraud case, that means the court must determine—before class certification, not after—whether reliance is a common or individual question. *See Halliburton*, 131 S. Ct. at 2184 ("Whether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance.").

A major purpose of Rule 23(b)(3) is to ensure that there is sufficient cohesion among class members to override the "individual autonomy [of] those who might prefer to go it alone or in a smaller unit" and to "warrant adjudication by representation." *Amchem Prods., Inc.* v. *Windsor*, 521 U.S. 591, 615, 623 (1997); *see also id.* at 621. Cohesion must be found before certification because it is only "class cohesion that legitimizes representative action in the first place." *Id.* at 623.

This is no mere quibble. The class-certification inquiry precedes litigation of putative class members' claims because the inquiry is about how that litigation ought to proceed. Here, if the district court were to determine during the certification inquiry that the fraud-on-the-market theory does not apply, and that any securities-fraud case is thus about individual direct reliance, then putative class members who directly relied on the defendants' statements could litigate their individual claims and control that litigation as they saw fit—advancing their own theories, proving their claims with their own evidence, and relying on their own counsel's skill and expertise. If the court instead deferred examination of any fraud-on-the-market predicate until after certification, and the judge or jury concluded *at that point* that the predicate was absent, it would be too late for those putative class members to litigate their direct-reliance claims. Once a class is certified in a fraud-on-the-market case, a failure of proof on any element, whether at summary judgment or trial, results in a judgment for the defendants that binds all class members who did not opt out of the class proceeding. *See* Fed. R. Civ. P. 23(c)(3)(B). Those with direct-reliance claims would then be precluded by res judicata from further litigation. *See, e.g.*, *San Remo Hotel, L.P.* v. *City & County of S.F.*, 545 U.S. 323, 336 n.16 (2005).

2. Respondent and the government try to sidestep these problems by asserting that the predominance inquiry is entirely about a single practical question: whether the case is likely to break down, after certification, into litigation of individual issues. *See, e.g.*, Resp. Br. 20-21, 41-42; U.S. Br. 7, 18. This argument fails for several reasons.

First, as demonstrated, Rule 23(b)(3) is concerned with more than simply testing whether a class proceed-

ing *could* be conducted. An important purpose of the rule is to determine whether a class proceeding *should* be conducted.

Second, the argument is inconsistent with *Amchem*. If Rule 23(b)(3) required only a practical examination of the contours of the post-certification litigation, then the predominance requirement would not apply to "settlement only" classes, because by definition there will never be any litigation of disputed issues after certification of a "settlement only" class, so it would not matter whether any issue could be settled by class-wide proof. But *Amchem* held that Rule 23(b)(3) does apply in that context. The Court there considered the predominance requirement in addressing a challenge to the certification of a "settlement only" class and rejected the certification order based in part on the failure to satisfy Rule 23(b)(3). *See* 521 U.S. at 622-625.

As the Court explained in *Amchem*, Rule 23(b)(3) is concerned with the cohesion of the class at the time of class certification. The Rule 23(b)(3) inquiry "trains on the legal or factual questions that qualify each class member's case as a genuine controversy." *Amchem*, 521 U.S. at 623. *Amchem* rested on the fact that those questions "preexist any settlement," *id.*—and thus they necessarily preexist any class-based litigation on the merits.[1]

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[1] To wring its preferred reading out of Rule 23(b)(3), under which a district court would focus only on the contours of the future class suit proposed by the plaintiff, the government alters the rule's text, rephrasing Rule 23(b)(3) as asking whether "'questions of law or fact common to class members [*will*] predominate'" U.S. Br. 4 (alteration in original) (emphasis added).

Third, Rule 23(b)(3) focuses not simply on "efficiently adjudicating" a controversy, but also on "*fairly* ... adjudicating" it. As explained above, a proper predominance finding ensures fairness to absent class members, particularly those with credible evidence of direct reliance. It also ensures fairness to defendants, who should not have to face the pressures of class litigation while the court defers the inquiry into whether a central issue in the case (here, reliance) is a common or individual one. That unfairness is especially apparent if the reason for the deferral is—as respondent and the government argue here—that the absence of a common reliance question will be remedied in the end by the *defendants'* victory on the materiality element. The defendant should not have to face the rigors and risks of class-action litigation in order to establish that a class action was never warranted.

3. The government seeks to distinguish materiality from the other fraud-on-the-market predicates, which must be proved before certification, on one ground alone. It asserts—as did the Ninth Circuit—that if a fraud-on-the-market class is certified without inquiring into the efficient-market and public-statement predicates, and the class later fails to prove one of those two predicates, then individual class members' claims "'would not be dead on arrival; they could seek to prove reliance individually.'" U.S. Br. 16 (quoting Pet. App. 9a). Because such individual litigation would (assertedly) still be possible, the government reasons, pre-certification proof of these two predicates is required to ensure "that the need for variegated proof of that sort would not arise at a later stage of the suit." *Id.* There is no similar need for pre-certification proof of the materiality predicate, the government says, because the absence of materiality creates "no

likelihood that individual issues will come to predominate in the subsequent course of the litigation." *Id.* at 18.

The government's premise is simply mistaken. As noted, the consequence of a certified class failing to prove *any* predicate in a fraud-on-the-market case is the same: The class loses and the judgment binds all of its members. There is no "risk" that upon a negative finding on the efficient-market or public-statement predicates, "individualized reliance inquiries will prove necessary." U.S. Br. 7. Rather, the class members' claims will be extinguished. Securities-fraud plaintiffs are not entitled to fully litigate their claims on a theory of common reliance and then, if they lose on that theory, take a second bite, starting over with the same claims but on new assertions of direct individual reliance.

The true reason for requiring pre-certification proof of the efficient-market and public-statement predicates is more straightforward: They are predicates to the fraud-on-the-market theory, and absent a showing that the theory is applicable, there can be no finding of predominance. *See Wal-Mart*, 131 S. Ct. at 2552 n.6; *Basic*, 485 U.S. at 242. That reason applies with equal force to the materiality predicate.[2]

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[2] Respondent asserts (Br. 43) that Amgen's position would logically require pre-certification proof of the falsity of any alleged misstatements. But proof of falsity is not required to invoke a presumption of common reliance because both true and false public statements can move the price of a stock traded in an efficient market—if the statements are material. By contrast, there is no basis under the fraud-on-the-market theory for presuming common reliance on immaterial statements because they do not move stock prices.

4. Respondent asserts at some length (Br. 22-26) that materiality is itself a question common to all class members. But as the government acknowledges (Br. 18), the same is true of the public-statement and efficient-market predicates. Determinations of those predicates will likewise apply to "the entire class in the same exact way." Resp. Br. 25. In any event, Amgen has not argued that materiality must be proved before certification in order to show that the *materiality* element presents common questions. Amgen's argument is that absent proof of all of the predicates of the fraud-on-the-market theory, the *reliance* element presents individual questions that will, as the Court said in *Basic*, preclude class certification. *See* 485 U.S. at 242. Respondent's extended discussion of whether materiality is itself a common question therefore misses the point.[3]

B. Requiring Pre-Certification Proof Of Materiality Does Not Prejudice Securities-Fraud Plaintiffs

Respondent contends (Br. 20, 33 & n.19, 35-36) that requiring pre-certification proof of materiality unfairly prejudices plaintiffs because of purported limits on their ability to conduct discovery into materiality. But Rule 23 authorizes courts to allow whatever discovery is needed to make the required findings regarding certification, *see* Pet. Br. 28 (citing authorities); *see also*,

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[3] For the same reason, respondent is wrong in asserting (Br. 24) that *Basic*'s (supposed) holding that materiality is a common question "is itself sufficient to dispose of this case." Any such holding would say nothing about whether pre-certification proof of the materiality predicate is required to enable plaintiffs to invoke *Basic*'s presumption as to reliance and therefore to allow the district court to make the required finding of predominance.

e.g., *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 319 n.20 (3d Cir. 2008)—a power that courts have in fact invoked, including in this case, *see, e.g.*, Resp. Br. 14 & n.10. More generally, respondent's assertion that requiring pre-certification proof of materiality would be unworkable is belied by the actual experience in circuits where such proof is currently mandated. As one amicus brief explains, for example, since the Second Circuit held in 2008 that such proof is required, "district judges within the Southern District of New York have, with no apparent problems, enforced" that mandate. Chamber of Commerce et al. Amicus Br. 21.[4]

Respondent also asserts (Br. 38) that "[d]eferring the class-certification decision until after full merits discovery would mean that the parties and the court would not know whether the proceeding was an individual or a class proceeding until a very late stage of the litigation." But this assumes, incorrectly, that "full merits discovery" is required. Again, Rule 23 permits courts to authorize the discovery needed to make the certification decision. *See* Fed. R. Civ. P. 23 advisory committee note (2003 amendments) (referring to "discovery in aid of the certification decision"). There is no reason why such targeted discovery need delay a certification decision "until a very late stage" (whatever that means). In any event, Rule 23 was amended in 2003 specifically to allow a discovery-based delay. *See id.* ("Time may be needed to gather information necessary to make the certification decision.").

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[4] The Chamber brief also answers respondent's complaint (Br. 33) that "Amgen fails to offer any insight regarding how plaintiffs should demonstrate materiality at the class-certification stage." The cases amici cite, and similar cases, provide ample "insight."

There is similarly no merit to respondent's related argument (Br. 36) that pre-certification proof of materiality should not be required because materiality "often requires expert evidence." As many courts have held, the discovery that Rule 23 authorizes may encompass expert evidence. *See, e.g.*, *Marcus* v. *BMW of N. Am., LLC*, 687 F.3d 583, 601 (3d Cir. 2012) ("[T]he court's obligation to consider all relevant evidence and arguments [on a motion for class certification] extends to expert testimony, whether offered by a party seeking class certification or by a party opposing it." (second alteration in original) (internal quotation marks omitted)). Indeed, determining whether the relevant market is efficient often involves expert testimony. *See, e.g.*, Pet. Br. 44 (citing *Teamsters Local 445 Freight Div. Pension Fund* v. *Bombardier Inc.*, 546 F.3d 196, 205-206 (2d Cir. 2008)); *In re Xcelera.com Sec. Litig.*, 430 F.3d 503, 512 (1st Cir. 2005) ("[T]he district court received and reviewed hundreds of pages of briefing and exhibits focused on the issue of market efficiency, received multiple affidavits from experts on both sides and heard two days of testimony from those experts and arguments from counsel regarding market efficiency."); *Schleicher* v. *Wendt*, 618 F.3d 679, 682 (7th Cir. 2010) ("A financial economist concluded, in an expert report that the district judge credited, that the market for Conseco's shares was efficient[.]"). Respondent itself introduced expert evidence below in seeking to prove the efficiency of the relevant market. *See* Pet. App. 40a.

Respondent also contends that "[r]esolving materiality at the class-certification stage ... would ... deprive defendants of a class-wide preclusive determination." Br. 20 (emphasis omitted); *see also id.* at 2, 35. Apart from the fact that the amicus briefs filed by groups representing securities-fraud defendants uniformly sup-

port Amgen (suggesting that they do not share respondent's concern), defendants are not *entitled* to a "class-wide preclusive determination" unless the court has properly determined that a class can be certified. The real threat of unfairness to defendants is that they might have to engage in unwarranted class litigation—and face unwarranted settlement pressure—because the putative class plaintiff was not first required to prove the materiality of the alleged misstatements even though it is a necessary predicate of the fraud-on-the-market-presumption of reliance.[5]

In any event, respondent's argument about the unavailability of preclusion is incorrect. If lead plaintiffs successfully prove materiality and otherwise satisfy the requirements for certification, then a class will be certified. And if the parties subsequently settle the case or it is litigated to judgment, there will be preclusive effect. Preclusion is denied to defendants only in cases in which a fraud-on-the-market predicate cannot be proved—*i.e.*, cases that should not be certified for class treatment in the first place.

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[5] Respondent dismisses (Br. 43-44) the magnitude and importance of the settlement pressure that results from class certification. It does so based principally on two law review articles (*see id.* at 44 n.27), ignoring the phalanx of contrary judicial authority, including decisions from this Court (*see* Pet. Br. 24-25), as well as the acknowledgement in the advisory committee note to the 1998 amendment to Rule 23 that "[a]n order granting certification ... may force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability." *See also* H. Friendly, *Federal Jurisdiction: A General View* 119-120 (1973) ("While the benefits to the individual class members are usually minuscule, the possible consequences of a judgment to the defendant are so horrendous that these actions are *almost always settled*." (emphasis added)).

C. Respondent's Remaining Arguments Lack Merit

1. Respondent repeatedly claims that Congress already addressed the problems that Amgen has identified, and argues that therefore Amgen is asking the Court to "displace Congress's considered policy judgments" regarding securities-fraud class actions. Br. 2; *see also id.* at 20, 21, 38-41; U.S. Br. 31-32. That is not correct.

To begin with, respondent mischaracterizes Amgen's position. Amgen's argument is simply that (a) class certification generates immense settlement pressure, especially in securities cases, and (b) this dynamic means that once a class has been certified courts will rarely if ever actually examine the materiality predicate to the fraud-on-the-market theory, even though that theory is indispensable to class treatment of securities-fraud claims. *See Basic*, 485 U.S. at 242. Respondent's assertions and authorities confirm, rather than contradict, the first point in Amgen's argument, and respondent simply ignores Amgen's second point.

In any event, as respondent acknowledges (*e.g.*, Br. 8, 38-39), the relevant policy judgment that Congress has made is that the class-action mechanism is often abused in securities-fraud cases. The concern about such abuse, moreover, has been substantial enough to impel Congress to take repeated affirmative steps to curb it. Far from displacing that congressional judgment, Amgen's position is consistent with it. That policy judgment is also properly a factor in resolving this case, just as it was in *Stoneridge Investment Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), where the Court expressed the need for "caution" about expanding the judicially created private right of

action under section 10(b) and explained that "restraint" was "appropriate in light of" Congress's steps to curb class-action abuse, *id.* at 165.

2. Respondent also asserts (Br. 34) that requiring pre-certification proof of materiality "would substantially increase the burdens on federal courts," by "splinter[ing] [a putative class claim] into separate claims by individual investors." To begin with, that assertion is in substantial tension with respondent's claim (Br. 37-38) that Amgen's position could "undermine[] the federal securities laws by creating the risk that millions of small investors ... will be deprived of the ability to vindicate their claims." The latter fails because Amgen's position leads to the denial of certification only where the plaintiff cannot prove the materiality predicate. In that circumstance, reliance is an individual issue, class certification is legally unwarranted, and it is less likely that there are any meritorious claims to be "vindicate[d]" on behalf of investors unaware of the alleged misrepresentations. *Id.* at 38. The claim of a possible burden on the courts, meanwhile, could be made in any case in which a putative class action fails to comply with the requirements of Rule 23.

3. There is likewise no merit to respondent's contention that Amgen's arguments regarding judicial economy and settlement pressure (*see* Pet. Br. 24-27) "prove[] far too much" (Resp. Br. 46) because they supposedly apply equally to loss causation, which this Court held in *Halliburton* need not be proved before class certification. But Amgen's argument is not that as many issues as possible should be adjudicated prior to class certification. No pre-certification proof is required on issues unconnected to the presumption of reliance (or otherwise to Rule 23's requirements). Amgen's argument instead is that among the reasons to

require pre-certification proof of matters that *are* necessary to the presumption of reliance are (1) to conserve judicial resources and (2) because otherwise the issues will often never be examined because certification will force a settlement despite the absence of a predicate to the very theory that allowed for class certification in the first place. *Halliburton* in no way undercuts that point. It did not rest on a rejection of concerns about judicial economy, meritless lawsuits, and consequent undue settlement pressure. Rather, *Halliburton* was driven by the fact that loss causation is not logically linked to the element of reliance, and therefore to *Basic*'s rebuttable presumption. *See* 131 S. Ct. at 2186; *see also* Pet. Br. 22. Materiality, by contrast, is.

4. Respondent also complains (Br. 32) that Amgen's position would "place[] courts in the difficult position of having to resolve an especially nuanced and fact-intensive issue at an early stage of litigation." The simple answer is that Rule 23 does not include an exception to its requirements for "fact-intensive" (or "difficult") matters. The "rigorous inquiry" and "close look" that must be made before a class can be certified, Pet. Br. 19-20 (citing cases), may indeed require the district court to make "difficult" decisions. *See Wal-Mart*, 131 S. Ct. at 2553 (requiring "significant proof"—before certification—that Wal-Mart had a "general policy of discrimination"). That is not a basis to excuse compliance with the Rule's mandates.

Respondent relatedly argues (Br. 33) that Amgen's position is undercut by its recognition (Pet. Br. 26 n.3) that the fact-specific nature of materiality often precludes summary judgment on that issue. But the reason summary judgment is often precluded is, as respondent notes (Br. 32 & n.18), that it cannot be granted when there are genuine disputes about impor-

tant facts. *See* Fed. R. Civ. P. 56(a). That says nothing about whether pre-certification proof of materiality should be required, because there is no prohibition on factfinding needed for class certification. To the contrary, "[b]efore deciding whether to allow a case to proceed as a class action, ... a judge should make whatever factual and legal inquiries are necessary under Rule 23." *Szabo* v. *Bridgeport Machs., Inc.*, 249 F.3d 672, 676 (7th Cir. 2001); *accord, e.g., In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 41 (2d Cir. 2006) ("[A] district judge may certify a class only after making determinations that each of the Rule 23 requirements has been met; ... such determinations can be made only if the judge resolves factual disputes relevant to each Rule 23 requirement and finds that whatever underlying facts are relevant to a particular Rule 23 requirement have been established."). The fact-sensitive nature of materiality—a characteristic that in any event does not distinguish it from the efficient-market predicate—is not a basis to allow proof of it to be deferred until after certification.

There is similarly no merit to respondent's arguments (Br. 32-33) regarding the standard of proof that governs factual determinations on a class-certification motion. Respondent complains (*id.* at 32) that the preponderance-of-the-evidence standard, which several circuits have held to apply to such determinations, "is far higher than the standard ... to defeat a motion for summary judgment." Thus, respondent continues, "Amgen's position would require plaintiffs to satisfy the standard that plaintiffs would face at trial, before discovery is even completed." *Id.* at 32-33 (emphasis omitted).

To begin with, Amgen has not urged this Court to adopt a particular standard of proof, and the Court could certainly reverse the Ninth Circuit without ad-

dressing that issue.[6] In any event, respondent's critique of the preponderance standard is unsound for at least three reasons. First, as discussed, courts can authorize whatever discovery is needed to decide the certification question. Second, the fact that a certification decision commonly precedes a summary-judgment ruling does not mean that the certification standard of proof must be lower than the summary-judgment standard. The two stages of litigation simply address different questions. (The same point refutes various amici's argument that pre-certification proof of materiality is unnecessary because defendants have an opportunity to challenge materiality on a motion to dismiss. Such a motion serves a different purpose from a certification motion.) Third, as respondent's argument reveals, this is not an issue unique to the materiality predicate, but rather is a complaint about having to prove anything at the class-certification stage. *Wal-Mart*, which holds that plaintiffs seeking class certification must prove Rule 23's requirements, including when they overlap with merits issues, *see* 131 S. Ct. at 2551-2552, decisively rejects that complaint.

5. Respondent does not contest the validity of the economic research presented in Amgen's opening brief (at 32-34) demonstrating that markets are often efficient in some respects but not others and that, therefore, courts cannot reliably conclude that invocation of

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[6] That said, this Court's opinion in *Wal-Mart* strongly suggests that the proper standard is indeed a preponderance. *See, e.g.*, 131 S. Ct. at 2551 ("A party seeking class certification must *affirmatively demonstrate* his compliance with the Rule—that is, he must be prepared to *prove* that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc." (first two emphases added)).

Basic's presumption is warranted in a particular case based only on a generic showing of market-wide efficiency. Respondent argues, however (Br. 47), that if existing tests for efficiency are flawed, "the solution is to revise the[m]." But that misses the point. Respondent's position, which would allow class certification based on little more than a showing of market efficiency, would lead to class certification in circumstances where no affirmative justification has been made in line with economic reality. Requiring pre-certification proof of materiality may not perfectly resolve this problem, but it would ensure that district courts conducting the class-certification inquiry in a fraud-on-the-market case are focused on (a) the market, (b) the particular statement(s), and (c) the reason for presuming the assimilation of the statement(s) into the market price.

II. DEFENDANTS MUST HAVE A FULL OPPORTUNITY TO REBUT THE FRAUD-ON-THE-MARKET THEORY BEFORE CERTIFICATION

Respondent concedes (Br. 53) that before certification defendants may present some evidence to rebut the applicability of the fraud-on-the-market theory, including evidence regarding the theory's efficient-market or public-statement predicates. *Accord* U.S. Br. 30-31. It nonetheless contends that defendants cannot offer similar evidence as to the materiality predicate. Such disparate treatment is neither sensible nor required by either Rule 23 or this Court's precedent.[7]

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[7] Respondent does not discuss the trade-timing predicate addressed in *Halliburton*. *See* 131 S. Ct. at 2185 ("It is common ground ... that plaintiffs must demonstrate [before certification] ...

1. As Amgen has explained (Br. 40-41), a successful rebuttal of materiality has the same effect on the *Basic* presumption as a rebuttal of the public-statement or efficient-market predicates: It eliminates "[t]he basis for finding that the fraud had been transmitted through market price," and therefore eliminates "the causal connection" that is essential to the fraud-on-the-market theory. *Basic*, 485 U.S. at 248. Because such rebuttal prevents proof of classwide reliance—a prerequisite to class certification, *see id.* at 242—courts must consider it at the certification stage.

Respondent asserts (Br. 52, 53) that rebuttal of materiality "does not actually rebut the fraud-on-the-market presumption," but instead "proves that no one in the class was defrauded." No case law is cited for this proposition—and it is flatly contradicted by *Basic*. There this Court described, as its first example of what would suffice "to rebut the presumption of reliance," a showing "that the 'market makers' were privy to the truth." 485 U.S. at 248.

2. Both respondent (Br. 54) and the government (Br. 30) rely on dicta in a *Basic* footnote stating that certain rebuttal proof "is a matter for trial." 485 U.S. at 249 n.29. But neither has any response to Amgen's point (Br. 42) that a literal reading of this language would also bar rebuttal of efficiency, which both respondent and the government concede is appropriate at the certification stage. Respondent also ignores Am-

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that the relevant transaction took place 'between the time the misrepresentations were made and the time the truth was revealed.'" (quoting *Basic*, 485 U.S. at 248 n.27)). For the reasons discussed herein and in our opening brief, it too would be subject to rebuttal at the certification stage.

gen's point (*id.*) that the footnote cited a section of Rule 23 that, at the time, authorized conditional certification orders, allowing deferral of difficult questions until later in the litigation. *See* Fed. R. Civ. P. 23(c)(1)(C) (1998). Rule 23 was amended in 2003 to remove that authority, and the advisory notes to that amendment instruct that "[a] court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been." The government responds (Br. 30 n.7) that district courts retain the authority to amend certification orders. That does not change the fact that when *Basic* made its "for trial" observation, conditional certification was an option, one that no longer exists. That is the salient point as to why the "for trial" dictum warrants little weight.

Respondent also argues (Br. 54) that the *Basic* Court would not have "affirmed the lower courts' class-certification order" if the Court "thought truth-on-the-market rebuttal evidence ... was relevant to class certification." To begin with, however, the *Basic* Court did not "affirm" the certification order. It said that the order was "appropriate when made," 485 U.S. at 250—*i.e.*, appropriate given the law as it existed prior to this Court's decision. And it expressly contemplated that the order would be "subject on remand to such adjustment, if any, as developing circumstances demand." *Id.* In any event, there is no indication that the *Basic* defendants actually sought to present rebuttal evidence.

3. Respondent does not dispute that if full rebuttal is precluded at the certification stage, defendants will often be denied any meaningful opportunity to rebut materiality because of the settlement pressure that certification creates. *See* Pet. Br. 41. And the government responds only (Br. 32-33) that such rebuttal can occur at summary judgment or trial—a response that

ignores the entire point, which is that settlement pressure will often prevent cases from reaching or completing those stages. Respondent and the government also offer no response to Amgen's argument (Br. 44-45) that it is both unfair and antithetical to our adversarial legal system to permit one side to obtain class certification based on the fraud-on-the-market presumption while preventing the other side from offering contrary evidence. That silence is telling.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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OCTOBER 2012

AMICUS CURIAE BRIEF

No. 11-1085

In the Supreme Court of the United States

AMGEN INC., ET AL., PETITIONERS

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

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QUESTIONS PRESENTED

1. Whether, in a private action under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, a plaintiff that invokes the fraud-on-the-market presumption of reliance must prove materiality in order for the suit to be maintained as a class action.

2. Whether, in such a case, the district court must allow the defendant at class certification to present evidence that the truth had reached the market and neutralized the defendant's alleged misstatements.

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In the Supreme Court of the United States

No. 11-1085

AMGEN INC., ET AL., PETITIONERS

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

INTEREST OF THE UNITED STATES

The United States, through the Department of Justice and the Securities and Exchange Commission (SEC), administers and enforces the federal securities laws. This case concerns the requirements for class certification in a private securities-fraud action in which the named plaintiff invokes the fraud-on-the-market presumption to establish the element of reliance. Meritorious private securities-fraud actions, including class actions, are an essential supplement to criminal prosecutions and SEC enforcement actions. The United States therefore has a substantial interest in this Court's resolution of the questions presented.

STATEMENT

1. Section 10(b) of the Securities Exchange Act of 1934 makes it unlawful for any person "[t]o use or employ, in connection with the purchase or sale of any security * * * , any manipulative or deceptive device or contrivance in contravention of" rules promulgated by the SEC. 15 U.S.C. 78j(b). Under SEC Rule 10b-5, which implements Section 10(b), it is unlawful for any person, in connection with the purchase or sale of a security, "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. 240.10b-5(b).

This Court long has construed Section 10(b) to provide a private right of action. *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 341 (2005) (citing cases). In order to recover in a private action under Section 10(b) and Rule 10b-5(b), a plaintiff must prove the following elements: (1) a material misrepresentation or omission by the defendant; (2) the defendant's scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) the plaintiff's reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation. *Id.* at 341-342; see, *e.g.*, *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1317 (2011).

Proof of reliance establishes the "requisite causal connection between a defendant's misrepresentation and a plaintiff's injury." *Basic Inc.* v. *Levinson*, 485 U.S. 224, 243 (1988); see *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008). The "traditional (and most direct) way a plaintiff can demonstrate reliance" on a defendant's misrepresentation is to

show that he was aware of and purchased stock "based on that specific misrepresentation." *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179, 2185 (2011). In *Basic*, however, this Court recognized an alternative approach, known as the "fraud-on-the-market" presumption, to proving the reliance element of a private Section 10(b) claim. 485 U.S. at 241-247. The Court observed that "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented [the plaintiffs] from proceeding with a class action, since individual issues then would have overwhelmed the common ones." *Id.* at 242. The Court further explained that a requirement of individualized proof "would place an unnecessarily unrealistic evidentiary burden" on securities-fraud plaintiffs who "traded on an impersonal market." *Id.* at 245.

The Court in *Basic* held that reliance may be presumed if a plaintiff shows that the defendant's material misrepresentation was transmitted to the plaintiff through the market price of the stock and the plaintiff purchased stock based on that price. 485 U.S. at 245-247; see *Erica P. John Fund*, 131 S. Ct. at 2185. This approach to proving reliance rests on the theory that "the market price of shares traded on well-developed markets reflects all publicly available information," including "any public material misrepresentations." *Basic*, 485 U.S. at 246-247. Because the market "transmits information to the investor in the processed form of a market price," a court may presume that an investor relies on the public misstatements when he "buys or sells stock at the price set by the market." *Erica P. John Fund*, 131 S. Ct. at 2185 (quoting *Basic*, 485 U.S. at 244, 247); see *Basic*, 485 U.S. at 244 (explaining that

"the market is performing a substantial part of the valuation process performed by the investor in a face-to-face transaction" (citation omitted)).

The fraud-on-the-market presumption is not a procedural rule specifically directed to the class-certification inquiry. Rather, the presumption is a substantive securities-law rule that governs the means by which private Section 10(b) plaintiffs can establish the reliance element of their claims, and it may be invoked in both individual and class actions. An important practical consequence of the fraud-on-the-market presumption, however, is to facilitate class certification by allowing the reliance element of a Section 10(b) suit to be proved through evidence common to all class members. That mode of proof increases the likelihood that "questions of law or fact common to class members [will] predominate" in the suit as a whole. Fed. R. Civ. P. 23(b)(3); see *Erica P. John Fund*, 131 S. Ct. at 2184.

A defendant may rebut the presumption of reliance through "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price." *Basic*, 485 U.S. at 248. As an example, the Court in *Basic* hypothesized a situation where "the truth" had entered the market "and dissipated the effects of the misstatements"—a rebuttal known as the truth-on-the-market defense. *Id.* at 248-249. The Court stated that "[p]roof of that sort is a matter for trial." *Id.* at 249 n.9.

2. Respondent is the lead plaintiff in a putative securities-fraud class action against Amgen, Inc., a pharmaceutical manufacturer, and several of its officers and directors (petitioners in this Court). Pet. App. 15a-16a. Respondent alleged that petitioners had made a series

of material misstatements and omissions about the safety, efficacy, and marketing of two of Amgen's flagship drugs. *Id.* at 16a; Consolidated Am. Class Action Compl. ¶¶ 1, 43, 128-177 (Oct. 1, 2007) (Compl.). Respondent further alleged that these misstatements and omissions had artificially inflated the price of Amgen's stock; that respondent and other members of the putative class had purchased the stock at the inflated price; and that they had suffered financial loss when the truth came to light and Amgen's stock price declined. *Id.* ¶ 202. Respondent also alleged that the market for Amgen securities was efficient and incorporated publicly available information into the price, and that all class members therefore had "suffered similar injury through their purchase of Amgen's securities at artificially inflated prices." *Id.* ¶¶ 199-200.

Respondent moved to certify a class of all persons who had purchased Amgen stock between April 22, 2004, and May 10, 2007. Pet. App. 16a. The district court granted that motion. *Id.* at 15a-50a. The court rejected petitioners' contention that respondent was required to prove the materiality of the alleged misstatements in order to satisfy the requirements of Federal Rule of Civil Procedure 23. *Id.* at 31a-38a.[1] The court also held that petitioners could not invoke the truth-on-the-market defense as a ground for resisting class certification. *Id.* at 40a-44a.

3. The court of appeals affirmed. Pet. App. 1a-13a. The court held that a plaintiff seeking to establish reliance through the fraud-on-the-market presumption is

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[1] The district court also held that respondent was not required to prove loss causation in order to obtain class certification. Pet. App. 38a-40a. This Court subsequently reached the same conclusion in *Erica P. John Fund*, 131 S. Ct. at 2186.

not required to prove materiality at class certification because "proof of materiality is not necessary to ensure that the question of reliance is common among all prospective class members' securities fraud claims." *Id.* at 12a. The court explained:

> If the misrepresentations turn out to be material, then the fraud-on-the-market presumption makes the reliance issue common to the class, and class treatment is appropriate. But if the misrepresentations turn out to be immaterial, then *every* plaintiff's claim fails on the merits (materiality being a standalone merits element), and there would be no need for a trial on each plaintiff's individual reliance. Either way, the plaintiffs' claims stand or fall together—the critical question in the Rule 23 inquiry.

Id. at 8a-9a.

The court of appeals further explained that, for these purposes, the question whether alleged misstatements were material differs from the questions "whether the securities market was efficient and whether the defendant's purported falsehoods were public," which must be resolved at the class-certification stage. Pet. App. 9a. Unlike materiality, the existence of an efficient market and the public dissemination of false statements "are not elements of the merits of a securities fraud claim. Thus, if the plaintiffs failed to prove those elements, they could not use the fraud-on-the-market presumption, but their claims would not be dead on arrival; they could seek to prove reliance individually. That scenario, however, would be inappropriate for a class proceeding." *Ibid.* (citation omitted).

The court of appeals also held that the "district court correctly refused to consider Amgen's truth-on-the-market defense at the class certification stage." Pet.

App. 12a-13a. The court observed that such a defense "is a method of refuting an alleged misrepresentation's *materiality*" and therefore is a "merits issue to be reached at trial or by summary judgment." *Id.* at 13a.

SUMMARY OF ARGUMENT

When a named plaintiff in a securities-fraud class action seeks to establish reliance through the fraud-on-the-market presumption, the plaintiff need not prove materiality to obtain class certification, and the defendant may not defeat certification by presenting evidence supporting a truth-on-the-market defense.

A. A named plaintiff seeking certification of a class must meet the requirements for class cohesion set out in Federal Rule of Civil Procedure 23. As relevant here, Rule 23(b)(3) requires that common questions of law or fact predominate over issues specific to individual class members. In securities-fraud cases, that inquiry often focuses on whether the element of reliance can be established through proof common to the plaintiff class.

To establish reliance, the named plaintiff in this case invoked the fraud-on-the-market presumption. Under that presumption, when the defendant makes public material misstatements in an efficient market, the misstatements are reflected in the stock's price, and it is presumed that the investor relies on the misstatements when he buys stock at the market price. See *Basic Inc.* v. *Levinson*, 485 U.S. 224, 244-247 (1988). The application of Rule 23(b)(3) in this case turns on whether respondent's failure to establish materiality at the class-certification stage creates a significant risk that individualized reliance inquiries will prove necessary as the case proceeds.

B. A class plaintiff invoking the fraud-on-the-market presumption need not prove materiality to establish that

the common issues predominate. A plaintiff must demonstrate that the market is efficient and that the defendant's statements were public. If a class was certified without inquiry into those factors, and the court subsequently determined that the market was not efficient or that the statements were not public, the reliance element of the plaintiffs' claims would depend on proof specific to individual class members, causing individual issues to predominate.

A failure to demonstrate materiality at the class-certification stage creates no similar risk. Because materiality is determined under a "reasonable investor" standard, it can be proved or disproved through evidence common to the class. And if petitioners' statements are ultimately found *not* to be material, judgment can be entered for petitioners on that basis, without the need for individualized reliance inquiries. There is consequently no basis for requiring this merits showing at class certification, because the class stands or falls together on the element of materiality. Failure to prove materiality does not show that individual issues predominate; it shows that the whole class loses on the merits. Thus, while a plaintiff must prove materiality to successfully establish fraud-on-the-market reliance at summary judgment or at trial, it need not do so at class certification.

C. Class certification is not the appropriate time to litigate a truth-on-the-market defense. Such a defense is a means of disproving materiality by showing that, in light of neutralizing disclosures, reasonable investors would not have regarded particular false statements as significant to their investment decisions. At summary judgment or at trial, petitioners' truth-on-the-market defense can be adjudicated based on proof that is com-

mon to all class members. And if the defense is successful, judgment can be entered for petitioners on the merits, without the need for further inquiry into individual plaintiffs' reliance.

Petitioner's policy concerns about abusive class actions do not justify supplementing the requirements of Rule 23. Congress sought to combat abusive securities-fraud actions by enacting legislation that heightened pleading standards and altered how securities-fraud class actions are litigated. The court of appeals appropriately declined to use Rule 23 to test the merits of respondent's claim. The judgment below should be affirmed.

ARGUMENT

A PRIVATE SECURITIES-FRAUD PLAINTIFF THAT INVOKES THE FRAUD-ON-THE-MARKET PRESUMPTION OF RELIANCE NEED NOT PROVE MATERIALITY TO OBTAIN CLASS CERTIFICATION, AND A DEFENDANT MAY NOT DEFEAT CERTIFICATION BY PRESENTING EVIDENCE THAT THE TRUTH REACHED THE MARKET

A named plaintiff seeking class certification in a securities-fraud case must establish that all of the prerequisites in Federal Rule of Civil Procedure 23 have been met. Contrary to petitioners' contention, respondent need not prove materiality to show that common questions of law and fact predominate over individual ones. Because materiality is based on a "reasonable investor" standard, the question whether petitioners' alleged misstatements were material can be resolved through common proof and will have a single answer for all members of respondent's proposed class. In addition, failure to decide the question of materiality at the class-certification stage creates no danger that individual issues will come to predominate over common ones as

the suit is litigated to its conclusion. If a class is certified and it is ultimately determined that petitioners' alleged misrepresentations were *not* material, all members of the plaintiff class will lose on the merits, and no individualized reliance inquiry will be necessary. Deferring resolution of the materiality issue until summary judgment or trial therefore does not create the risk of variegated proof that concerned the Court in *Basic*.

A. Whether To Certify A Fraud-On-The-Market Class Depends Solely On Whether The Plaintiffs Have Met The Requirements Of Rule 23

1. In order to certify a case as a class action, a federal district court must determine that the proposed class satisfies the requirements imposed by Federal Rule of Civil Procedure 23. See, *e.g.*, *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541, 2548 (2011); *Shady Grove Orthopedic Assocs., P.A.* v. *Allstate Ins. Co.*, 130 S. Ct. 1431, 1437 (2010). Under Section (a) of Rule 23, the named plaintiff must show: (1) numerosity, *i.e.*, that "the class is so numerous that joinder of all members is impracticable"; (2) commonality, *i.e.*, that "there are questions of law or fact common to the class"; (3) typicality, *i.e.*, that "the claims or defenses of the representative parties are typical of the claims or defenses of the class"; and (4) adequacy of representation, *i.e.*, that "the representative parties will fairly and adequately protect the interests of the class." Fed. R. Civ. P. 23(a).

The party seeking certification also must establish that the proposed class fits into one of the categories described in Section (b) of Rule 23. See *Wal-Mart*, 131 S. Ct. at 2551. Section (b) provides that a class action may be maintained if: (1) prosecuting separate actions would risk adversely affecting class members or the opposing party; (2) "the party opposing the class has acted or re-

fused to act on grounds that apply generally to the class" and "final injunctive relief or corresponding declaratory relief is appropriate" on a class-wide basis; or (3) "questions of law or fact common to class members predominate over any questions affecting only individual members" and "a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b). Rule 23 "does not set forth a mere pleading standard"; rather, the named plaintiff must "affirmatively demonstrate his compliance with the Rule." *Wal-Mart*, 131 S. Ct. at 2551; see *Amchem Prods., Inc.* v. *Windsor*, 521 U.S. 591, 613-614 (1997); *General Tel. Co. of Sw.* v. *Falcon*, 457 U.S. 147, 160 (1982).

The district court's Rule 23 analysis may "entail some overlap with the merits of the plaintiff's underlying claim," because the court may need to "probe behind the pleadings" to consider how the plaintiff's claim will be proved. *Wal-Mart*, 131 S. Ct. at 2551-2552 (quoting *Falcon*, 457 U.S. at 160). "If something about 'the merits' also shows that individual questions predominate over common ones, then certification may be inappropriate." *Schleicher* v. *Wendt*, 618 F.3d 679, 685 (7th Cir. 2010). But so long as the relevant merits determinations "affect[] investors in common" and "can be made on a class-wide basis," a court may not deny class certification based on its view that the defendant will ultimately prevail. *Id.* at 687; see Fed. R. Civ. P. 23(c)(1) advisory committee's note (2003) ("[A]n evaluation of the probable outcome on the merits is not properly part of the certification decision."). Regardless of the plaintiff's perceived likelihood of success, Rule 23 "creates a categorical rule entitling a plaintiff whose suit meets the

specified criteria to pursue his claim as a class action." *Shady Grove*, 130 S. Ct. at 1437.

2. At issue in this case is the requirement that "questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). This predominance inquiry "tests whether proposed classes are sufficiently cohesive to warrant adjudication by representation." *Amchem*, 521 U.S. at 623. To satisfy Rule 23(b)(3), a plaintiff must establish that the elements of the cause of action are "capable of proof at trial through evidence that is common to the class rather than individual to its members." *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 311-312 (3d Cir. 2008).

In this case, as in many private securities-fraud cases, several of the elements are susceptible to common proof. See, *e.g.*, *Amchem*, 521 U.S. at 625 ("Predominance is a test readily met in certain cases alleging consumer or securities fraud."). Respondent has alleged that petitioners made material misstatements and omissions that inflated Amgen's stock price; that Amgen's stock price declined when the truth came to light; and that the members of the class (*i.e.*, persons who had purchased Amgen stock between the initial misstatements and omissions and the later corrections) suffered economic loss as a result. Compl. ¶¶ 128-177; see Pet. App. 16a-19a. Whether petitioners made material misstatements or omissions, whether they acted with scienter, and whether the misstatements and omissions inflated the stock price are questions common to all class members. See *Schleicher*, 618 F.3d at 681. For that reason, petitioners do not dispute that respondent has satisfied the commonality requirement in Rule 23(a)(2). See Pet. App. 24a.

The parties disagree, however, about the application of Rule 23(b)(3) to the element of reliance in this case. See *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179, 2184 (2011) ("Whether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance."); see also Pet. Br. 4. To establish reliance, respondent invoked the fraud-on-the-market presumption. Compl. ¶¶ 199-200. Petitioners contend (Br. 19) that, "[b]ecause materiality is an indispensable predicate of the fraud-on-the-market theory, * * * Rule 23 requires that it * * * be proved before class certification."

Although individual securities-fraud plaintiffs may seek to use the fraud-on-the-market presumption to establish reliance, the presumption has particular practical significance in the class-action context. "Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented [private securities-fraud plaintiffs] from proceeding with a class action, since individual issues would have overwhelmed the common ones." *Basic*, 485 U.S. at 242. The application of Rule 23(b)(3) to this case turns on whether the failure to assess materiality at the class-certification stage creates a significant risk that individualized reliance inquiries will ultimately become necessary, causing issues specific to individual plaintiffs to predominate over issues common to the class.

As we explain below, and as the court of appeals correctly recognized, deciding materiality at summary judgment or trial creates no danger that individual issues will come to predominate as the litigation proceeds. Because materiality is a separate element of *every* private Section 10(b) claim (whether or not the plaintiff invokes the fraud-on-the-market presumption), an eventu-

al determination that petitioners' alleged misstatements were not material would provide an independent ground for judgment in petitioners' favor, obviating any need for the sort of individualized reliance inquiry to which the Court referred in *Basic*. Materiality therefore is not the sort of threshold question that must be decided at the class-certification stage in order to ensure that Rule 23(b)(3)'s predominance requirement is satisfied.

B. A Securities-Fraud Plaintiff Relying On The Fraud-On-The-Market Presumption Need Not Prove Materiality To Obtain Class Certification

1. At class certification, a securities-fraud plaintiff must make certain showings with respect to the fraud-on-the-market presumption in order to ensure that reliance can be established without the need for individualized proof. In this case, the courts below correctly "require[d] [respondent] to prove at the class certification stage that the market for Amgen's stock was efficient and that Amgen's supposed misstatements were public." Pet. App. 9a; see *Erica P. John Fund*, 131 S. Ct. at 2185; see also *Wal-Mart*, 131 S. Ct. at 2552 n.6 (identifying, as one example of a merits issue that must be resolved at the class-certification stage, the question whether shares involved in a private securities-fraud suit were traded on an efficient market).

Proof of those components at the class-certification stage is necessary to ensure that the class claims can be resolved without the need for individualized reliance inquiries. The plaintiff must show that the market was efficient with respect to the stock at issue so that the alleged misstatements or omissions would be reflected in the stock's price. Because "the market price of shares" in an efficient market "reflects all publicly available information," including any material information, proof of

market efficiency shows that the market will transmit a material misstatement through the stock's price. *Basic*, 485 U.S. at 246. The plaintiff also must show that the alleged misrepresentations were made publicly, because the market would not take into account information unknown to it. *Ibid.*; see *Erica P. John Fund*, 131 S. Ct. at 2185 (noting that "the alleged misrepresentations" must be "publicly known," because otherwise, "how would the market take them into account?"). When those prerequisites are satisfied, plaintiffs can establish "the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury," *Basic*, 485 U.S. at 243, through proof common to the class.[2]

Those determinations must be made at the class-certification stage, rather than deferred for later resolution at summary judgment or trial, in order to ensure that common questions will predominate as the case is litigated to its conclusion. If a class were certified and the plaintiffs ultimately failed to prove market efficiency or public dissemination of the alleged misrepresentations, the plaintiffs "could not use the fraud-on-the-

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[2] Petitioner contends (Br. 22-23) that at class certification, a securities-fraud plaintiff relying on the fraud-on-the-market presumption also must prove that the named plaintiff and the members of the putative class traded stock between the time of the alleged misrepresentation and the time the truth was revealed. That requirement is better understood as a limit on the definition of the class, rather than a fact that the named plaintiff must prove for each class member at class certification. Precise identification of the times when the alleged misrepresentation was made and the truth was subsequently revealed is also important to ensure that the named plaintiff has traded stock during the time the stock price allegedly was distorted by the defendant's misrepresentations, so that the named plaintiff's claim is typical of the class members' claims. See Fed. R. Civ. P. 23(a)(3).

market presumption, but their claims would not be dead on arrival; they could seek to prove reliance individually." Pet. App. 9a. At that point, however, "individual issues then would * * * overwhelm[] the common ones," and class certification would not be appropriate. *Basic*, 485 U.S. at 242; see Pet. App. 9a (efforts by class members "to prove reliance individually * * * would be inappropriate for a class proceeding"). In order to "affirmatively demonstrate [its] compliance with" Rule 23, *Wal-Mart*, 131 S. Ct. at 2551, respondent therefore was required to establish at the class-certification stage that the need for variegated proof of that sort would not arise at a later stage of the suit.

In this case, petitioners conceded that the market for Amgen stock was efficient, and they did not contest that the alleged misstatements were public. Pet. App. 5a-6a. Because "[t]he public information [wa]s reflected in the market price of the security" and the investors bought at the market price, the courts below correctly held that the case could proceed as a class action on the assumption that the investors "relie[d] upon [petitioners'] statements." *Stoneridge*, 552 U.S. at 159. That common path to proving reliance made class certification appropriate.

2. A plaintiff who invokes the fraud-on-the-market presumption need not establish materiality at the class-certification stage. The relevant question at class certification is whether the plaintiff has shown that common issues will predominate over issues specific to particular class members. See, *e.g.*, *Falcon*, 457 U.S. at 155 (the appropriateness of certification depends on whether "the issues involved are common to the class as a whole" and whether "they turn on questions of law applicable in

the same manner to each member of the class" (citation and internal quotation marks omitted)).

An alleged misstatement or omission is material if there is "a substantial likelihood" that it "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic*, 485 U.S. at 231-232 (quoting *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976)). The "role of the materiality requirement" is to "filter out essentially useless information that a reasonable investor would not consider significant." *Id.* at 234. The materiality standard "is an objective one" that focuses on "the significance of an omitted or misrepresented fact to a reasonable investor," not to any particular investor. *TSC Indus.*, 426 U.S. at 445.

For that reason, the issue "whether a statement is materially false is a question common to all class members." *Schleicher*, 618 F.3d at 687. With respect to the resolution of the materiality issue itself, "questions of law or fact common to class members" clearly will "predominate over questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). Indeed, the determination whether petitioners' alleged misrepresentations were material will not require *any* inquiry into particular class members' investing histories or other personal circumstances.

Unlike materiality, some threshold questions must be resolved at the class-certification stage, even though the answers will be the same for all members of the proposed class, in order to ensure that common questions will predominate over individual ones during the subsequent course of the litigation. In *Basic*, for example, the district court could not appropriately have certified a class without first determining whether the fraud-on-

the-market presumption was a valid means of proving reliance in a Section 10(b) suit. Although the question "Is the fraud-on-the-market theory valid?" would necessarily have the same answer for all potential plaintiffs, the court in *Basic* was required to answer that question at the class-certification stage in order to determine whether reliance could be proved through evidence common to the class, or whether issues specific to individual plaintiffs would instead predominate. See 485 U.S. at 242. For similar reasons, respondent in this case was required to prove market efficiency and public dissemination at the class-certification stage, even though neither the efficiency of the market nor the public nature of the alleged misrepresentations would vary from investor to investor. See pp. 14-16, *supra*.

The issue of materiality, however, raises no similar concern. If a class is certified and petitioners' alleged misrepresentations are ultimately found not to be material, there is no likelihood that individual issues will come to predominate in the subsequent course of the litigation. "[B]ecause materiality is an element of the *merits* of their securities fraud claim, the plaintiffs cannot both fail to prove materiality yet still have a viable claim for which they would need to prove reliance individually." Pet. App. 8a. Rather, "if the misrepresentations turn out to be immaterial, then *every* plaintiff's claim fails on the merits." *Ibid.* Because "the plaintiffs' claims stand or fall together" regardless of the ultimate resolution of the materiality question, *id.* at 8a-9a, that issue need not be decided at the class-certification stage of the case.

Petitioners assert that "without the [fraud-on-the-market] presumption, the class members would have to prove reliance individually." Br. 21. But the accuracy of

that statement depends on the *reason* the fraud-on-the-market presumption is inapplicable to a particular case. If the presumption is rendered inapplicable by the plaintiffs' failure to prove materiality, judgment can be entered for the defendant on that independent ground, obviating any need (and any opportunity) for the plaintiffs "to prove reliance individually." It is therefore "possible to certify a class under Rule 23(b)(3) even though all statements turn out to have only trivial effects on stock prices"; in such a case, "[c]ertification is appropriate, but the class will lose on the merits." *Schleicher*, 618 F.3d at 685.

There is also no merit to petitioners' contention (Br. 35) that the court below contravened this Court's decision in *Wal-Mart* by taking account of the fact that materiality is an element of respondent's merits claim. The court of appeals did not rely on any rigid view, of the sort specifically disapproved in *Wal-Mart* (see 131 S. Ct. at 2551-2552 & n.6), that merits issues are categorically irrelevant to the class-certification decision. Rather, the court carefully explained how the status of materiality as a separate merits element bears on the Rule 23(b)(3) inquiry. See Pet. App. 8a-9a. That approach was fully consistent with this Court's admonition that lower courts, in deciding whether class certification is appropriate, must address merits issues to the extent necessary to ensure that Rule 23's requirements are satisfied.[3]

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[3] Contrary to petitioners' contention (Br. 37), the court below cogently explained why materiality differs for these purposes from market efficiency and public disclosure, which must be proved at class certification. The court explained that, whereas a failure of proof on materiality allows judgment to be entered against all class members, a failure of proof on market efficiency or public disclosure

3. Petitioners contend that a plaintiff in a fraud-on-the-market case must prove materiality to obtain class certification "[b]ecause materiality is a predicate to the *Basic* presumption" and that "presumption [is] needed to satisfy Rule 23's prerequisites." Br. 9; see *id.* at 17-18, 38-40. Petitioners are mistaken.

Petitioners' core argument is that no class could properly be certified until respondent established that the class members could actually prove reliance through common evidence. But even in properly certified class actions, plaintiffs often ultimately fail to prove an element of their claims through common evidence because they cannot prove that element *at all*. The result in such a case is judgment for the defendant on the merits, which binds all class members and thereby serves a core purpose of the class-action mechanism. Unless the failure of *common* proof gives rise to a need for *individualized* proof, it does not cast doubt on the propriety of class certification.

Petitioners do not dispute that materiality is an objective inquiry and that proof of materiality therefore is the same for all class members. Indeed, petitioners agree (Br. 13 n.1) that whether an alleged misstatement is material depends on whether a "reasonable investor" would view the information as "as having significantly altered the total mix of information" available. *Ibid.* (quoting *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1318, 1318 (2011)). Because materiality does not depend on any particular investor's subjective reaction to information, petitioners' alleged misstatements

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leaves open the possibility that some class members may have meritorious claims, so long as they can establish individualized reliance. See Pet. App. 8a-9a.

will by definition be material or immaterial for all class members.

Petitioners also make no meaningful effort to demonstrate that certification of a class without a determination as to materiality will create any risk that individual issues will predominate as the suit is litigated to judgment. In particular, petitioners do not attempt to rebut the court of appeals' explanation (Pet. App. 8a) that, if petitioners' alleged misrepresentations are ultimately found to be immaterial, there will be no need for individualized reliance inquiries.[4] Rather, petitioners appear to argue that, because the fraud-on-the-market presumption *as a whole* facilitates class certification by allowing reliance to be shown through common proof, and the Court in *Basic* described materiality as an essential predicate to the successful invocation of that presumption, a finding of materiality should be a prerequisite to class certification. See, *e.g.*, Pet. Br. 22 (arguing that any "matters that are logically connected to reliance * * * have to be proven at class certification" (emphasis omitted)).

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[4] Petitioners contend that a defendant's entitlement to judgment when plaintiffs fail to prove materiality "is irrelevant to whether individualized issues predominate on the distinct element of reliance." Br. 36. It is true that, even when a defendant's statements are found to be immaterial, some class members might possess evidence that they subjectively relied on the statements in making their own investment decisions. But since a failure of proof on materiality provides a sufficient ground for rejecting a private Section 10(b) claim, the court in such a case would have no occasion to admit or evaluate any plaintiff-specific evidence of direct reliance. The theoretical possibility of individualized reliance issues that will not actually be litigated cannot cause individual issues to predominate. Cf. Fed. R. Civ. P. 23(c)(1) advisory committee's note (2003) (court at class-certification stage considers "how the case will be tried").

Neither the text of Rule 23(b)(3) nor this Court's decisions construing the Rule support that approach to the predominance requirement. Rule 23 "creates a categorical rule entitling a plaintiff whose suit meets the specified criteria to pursue his claim as a class action." *Shady Grove*, 130 S. Ct. at 1437. Where (as here) a plaintiff invokes Rule 23(b)(3) as a basis for class certification, the court must conduct whatever threshold inquiries are necessary to determine whether "the questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3); see *Wal-Mart*, 131 S. Ct. at 2551-2552. Consistent with that understanding, respondent was required to establish market efficiency and public dissemination at the class-certification stage, even though both those facts would also be part of respondent's proof on the merits. The court below properly declined, however, to require proof of an additional element (materiality) that, while "logically connected" (Pet. Br. 22) to the overall reliance inquiry, has no independent bearing on the determination whether common issues of law or fact predominate.

At the class-certification stage of a securities-fraud suit, the pertinent question is not whether plaintiffs can actually establish the reliance (or any other) element of their claims, but whether those claims can be proved or disproved through evidence common to all class members. If a company makes a misstatement that is not material, *i.e.*, if there is no "substantial likelihood" that "a reasonable investor would consider it important," *Basic*, 485 U.S. at 231-232 (citation omitted), then the misstatement would not distort the stock's price.[5] And if

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[5] "Price distortion" can occur even if a company's false statement does not cause the price of its stock to increase, so long as the mis-

the misstatement has not distorted the stock's price, the fraud-on-the-market presumption cannot "provide[] the requisite causal connection between a defendant's misrepresentation" and any economic loss the plaintiff may have suffered. *Id.* at 243.

Accordingly, if a plaintiff cannot ultimately prove materiality, the plaintiff will not be able to establish reliance through the fraud-on-the-market presumption. That prospect does not suggest that individual issues will then predominate, however, since the plaintiffs' failure of proof on the separate element of materiality will result in judgment for the defendant, leaving the court with no individualized reliance inquiries to conduct. See Pet. App. 8a. Thus, while a plaintiff must prove materiality in order to *successfully* invoke the fraud-on-the-market presumption at summary judgment or at trial, it need not offer such proof at the class-certification stage to show that common issues will predominate.

Petitioners rely (Br. 15-18) on this Court's references to materiality in its discussion of the fraud-on-the-market presumption in *Basic*. See, *e.g.*, 485 U.S. at 245 (describing the presumption "that persons who had traded Basic shares had done so in reliance on the integrity of the price set by the market, but because of petitioners' material misrepresentations that price had been fraudulently depressed"). But that discussion concerns whether the theory behind the fraud-on-the-market pre-

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representation causes the stock to have a different price than it would have had if the truth had been known. Thus, misrepresentations that prevent or slow the fall of a price may be just as important to investors as misrepresentations that increase the price. *Schleicher*, 618 F.3d at 683-684. Price distortion is not the only method by which a plaintiff, including a federal law enforcement agency, may prove materiality. See Former SEC Comm'rs Br. 18-20.

sumption is substantively valid, not what must be established to obtain class certification in a fraud-on-the-market case. The Court's references to materiality simply reflect the fact that false or misleading statements will not distort the price of a stock unless the misstatements are material. See *id.* at 241-242, 244-245. Indeed, although the Court in *Basic* repeatedly used the phrase "material misrepresentations" in discussing the fraud-on-the-market presumption, *id.* at 244, 245, 246, 247, petitioners do not contend that a plaintiff must prove at class certification that any "misrepresentations" actually occurred—*i.e.*, that the statements alleged to be false were in fact false. Cf. *Schleicher*, 618 F.3d at 685 ("Falsehood and materiality affect investors alike.").

The *Basic* Court never suggested that a plaintiff must prove materiality to obtain class certification in a fraud-on-the-market case. To the contrary, the Court noted at the outset of its discussion that the case involved "several common questions of law and fact," including "the falsity or misleading nature of the three public statements," "the presence or absence of scienter," and "*the materiality of the misrepresentations*, if any." *Basic*, 485 U.S. at 242 (emphasis added). The Court therefore recognized that materiality, like falsity and scienter, is an issue common to all class members in a fraud-on-the-market case.[6]

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[6] In footnote 27 of *Basic*, the Court noted that the court of appeals had required the plaintiff to "allege and prove" certain facts, including "that the misrepresentations were material," "in order to invoke the presumption" of reliance. *Basic*, 485 U.S. at 248 n.27. The courts of appeals that have required plaintiffs in fraud-on-the-market cases to prove materiality at class certification have based their holdings on that footnote. See, *e.g.*, *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 481 (2d Cir. 2008); *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 7 n.11 (1st Cir. 2005). But the footnote simply described

4. Petitioners' reliance (Br. 22) on *Erica P. John Fund* is misplaced. In that case, the Court held that a plaintiff need not prove loss causation in order to proceed with a class action using the fraud-on-the-market presumption, because proof of that element was not necessary to show that reliance was an issue common to class members. 131 S. Ct. at 2185-2187. The "fundamental premise" of the fraud-on-the-market presumption, the Court observed, is that "an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction." *Id.* at 2186. The Court further explained that proof of loss causation is not necessary to "establish the efficient market predicate to the fraud-on-the-market theory." *Ibid.*

Similarly here, once the named plaintiff shows the facts sufficient to establish the "efficient market predicate," then the named plaintiff has shown that individualized reliance inquiries will be unnecessary, and the named plaintiff need not prove materiality at class certification. Materiality is more closely related to reliance than is loss causation, because a plaintiff who cannot prove materiality cannot prove reliance on a distorted market price. See pp. 22-23, *supra*. As with loss causation, however, a plaintiff's failure to prove materiality will not engender any need for individualized inquiries

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what the lower court had held must be proved *at trial* to invoke the presumption. 485 U.S. at 248 n.27; see *Schleicher*, 618 F.3d at 687; see also Pet. App. 34a-35a. Indeed, the same footnote referred to the court of appeals' requirement of proof "that the defendant made public misrepresentations." 485 U.S. at 248 n.27. Petitioners do not contend, however, that proof of actual "misrepresentations" is required at the class-certification stage.

on the issue of reliance. Proof of materiality therefore is not a prerequisite for class certification.

Wal-Mart confirms that the focus at class certification must be on compliance with Rule 23, not on the plaintiffs' prospects of ultimate success. See 131 S. Ct. at 2551. There, the named plaintiffs sued "about literally millions of employment decisions at once." *Id.* at 2552. The Court explained that "[w]ithout some glue holding the alleged *reasons* for all those decisions together, it will be impossible to say that examination of all the class members' claims for relief will produce a common answer to the crucial question *why was I disfavored.*" *Ibid.* Because the plaintiffs had "provide[d] no convincing proof of a company-wide discriminatory pay and promotion policy," the Court held that the case was not suitable for class-wide resolution. *Id.* at 2556.

Here, the "glue" holding the plaintiffs together is the transmittal of the defendants' alleged public misstatements to them through the price set by an efficient market. In *Wal-Mart*, the absence of a company-wide policy of discrimination precluded class certification, but it did not foreclose the possibility that some class members could establish meritorious Title VII claims through individualized proof. If respondent had failed to prove market efficiency, the members of the proposed class in this case would be in an analogous position, free to prove actual reliance on an individualized basis, but unable to establish fraud-on-the-market reliance through evidence common to the class. The failure to prove materiality would have no similar effect, however, since it would compel rejection of *all* the class members' claims based on evidence and findings common to the class.

C. A Defendant May Not Present A Truth-On-The-Market Defense At Class Certification

1. Under Federal Rule of Civil Procedure 23, a district court has no "'authority to conduct a preliminary inquiry into the merits of a suit'" at class certification unless it is necessary "to determine the propriety of certification." *Wal-Mart*, 131 S. Ct. at 2552 n.6 (quoting *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974)). Accordingly, the question whether a defendant may assert a particular defense at class certification, like the question whether a named plaintiff must prove materiality at that stage, depends on the relationship between that defense and the requirements of Rule 23.

Petitioners contend (Br. 40-45) that they should be permitted to "rebut the fraud-on-the-market theory" at class certification by establishing that the truth reached the market and neutralized their alleged misstatements. In their view, proof of such a defense is appropriate at class certification because it would eliminate "[t]he basis for finding that the fraud had been transmitted through [the] market price" and therefore show that reliance is not a common issue. *Id.* at 41 (quoting *Basic*, 485 U.S. at 248). Petitioners explain that, "[i]n the district court, Amgen sought to show that in light of all the information available to the market, the alleged Amgen misstatements could not be presumed to have altered the market price *because they would not have significantly altered the total mix of information made available.*" *Id.* at 40-41 (emphasis added; citation and internal quotation marks omitted). As the italicized language makes clear, petitioners' theory is that their truth-on-the-market evidence would rebut the presumption of reliance by showing the alleged misstatements to be immaterial. See Pet. App. 13a (explaining that "the truth-on-the-market

defense is a method of refuting an alleged misrepresentation's *materiality*").

Petitioner's proposed defense was anticipated by the Court in *Basic*. After defining the fraud-on-the-market presumption of reliance, the Court noted that the presumption is rebuttable, and it explained various ways in which it could be disproved. *Basic*, 485 U.S. at 248-249. The Court stated that "[a]ny showing that severs the link between the alleged misrepresentations and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance." *Id.* at 248. The Court observed that one way a defendant could disprove reliance would be to show that the truth had "credibly entered the market and dissipated the effects of the misstatements." *Id.* at 249. In that instance, the Court explained, "those who traded Basic shares after the corrective statements would have no direct or indirect connection with the fraud." *Ibid.*

2. A truth-on-the-market defense does not defeat predominance because it does not disprove the class members' common path to proving reliance or suggest that individual reliance issues will predominate. By proving market efficiency and public dissemination, the named plaintiff demonstrates that reliance can be established through common proof. See *Basic*, 485 U.S. at 244-245; see also *Erica P. John Fund*, 131 S. Ct. 2185. Proof that the truth entered the market does not cast doubt on the presumption that an efficient market "transmits information to the investor in the processed form of a market price." *Ibid.* (quoting *Basic*, 485 U.S. at 244). Rather, it shows that truthful information was also transmitted through the same market mechanisms,

and that the truthful information neutralized the defendant's misstatements.

Evidence that the truth neutralized the alleged misstatements affects all investors in common, and the district court could resolve the question whether the truth neutralized the misstatements "in one stroke." *Wal-Mart*, 131 S. Ct. at 2551. If (as petitioners contend) the neutralizing disclosures would have dissuaded a reasonable investor from attaching weight to petitioners' alleged misrepresentations, petitioners will ultimately be entitled to judgment on the ground of immateriality. As explained above, that disposition would obviate any need for individualized reliance inquiries. Petitioners' successful assertion of a truth-on-the-market defense at summary judgment or trial therefore would mean that all investors lose on the merits, not that the class members' claims are dissimilar or that individual issues predominate, and thus would confirm that the case was appropriate for class certification.

Indeed, the truth-on-the-market defense has the same underpinning as the fraud-on-the-market presumption of reliance: both rest on the premise that public statements made in an efficient market are transmitted to an investor through the stock price. The fraud-on-the-market presumption concerns the distorting effect of misstatements, while the truth-on-the-market defense concerns the neutralizing effect of truthful statements. Both theories, however, presume an efficient market, public statements, and investors purchasing stock in reliance on the integrity of the market price. See *In re Merck & Co., Inc. Sec. Litig.*, 432 F.3d 261, 271 (3d Cir. 2005) ("An efficient market for good news is an efficient market for bad news.").

The conclusion that a defendant cannot assert a truth-on-the-market defense at class certification is consistent with *Basic*. The Court recognized that a defendant may rebut the presumption of reliance, but it did not say that rebuttal is always appropriate at class certification. To the contrary, after explaining that the fraud-on-the-market presumption might be rebutted by proof that the truth had "credibly entered the market and dissipated the effects of the misstatements" on the stock's price, the Court stated that "[p]roof of that sort is a matter for trial, throughout which the District Court retains the authority to amend the certification order as may be appropriate." 485 U.S. at 249 & n.29.[7]

3. Unlike the truth-on-the-market defense, some arguments can appropriately be presented by defendants at class certification. In this case, petitioners conceded market efficiency, Pet. App. 6a, but defendants in other securities-fraud cases have disputed that a market for a certain stock incorporated all public statements into the price. See *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 11-17 (1st Cir. 2005). If a market does not "transmit[] information to the investor in the processed form of a market price" the class members do not have a common path for receiving and acting on the defendant's alleged misstatements, and reliance will become an individualized issue. *Basic*, 485 U.S. at 244 (citation omitted). By

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[7] Petitioners contend (Br. 42) that the Court's statement about a truth-on-the-market defense being a "matter for trial" should be discounted because it was premised on the district courts being authorized to grant conditional class certification. Petitioners are mistaken. The *Basic* Court never mentioned conditional certification; instead, the Court noted that the district court may "amend the certification order as may be appropriate" as the case develops, 485 U.S. at 249 n.29, and the district courts retain that authority today, see Fed. R. Civ. P. 23(c)(1)(C).

the same logic, a defendant could attempt to prove that the alleged misstatements were not made publicly, because if they were not "publicly known," the market would not "take them into account." *Erica P. John Fund*, 131 S. Ct. at 2185.

Petitioners argue at length (Br. 30-34) about what proof of market efficiency courts should require in determining whether to presume that a defendant's misstatements were transmitted to investors through the market price. Those arguments are beside the point because petitioners conceded market efficiency here. Whether or not the tests used by the courts of appeals reliably predict market efficiency in certain cases therefore is a question for another day. To the extent a defendant wishes to challenge market efficiency in a fraud-on-the-market case, all agree that it may do so at class certification. See *Wal-Mart*, 131 S. Ct. at 2552 n.6; *Erica P. John Fund*, 131 S. Ct. at 2185.

4. A central theme of petitioners' brief is that a securities-fraud plaintiff should be required to prove materiality at class certification, and defendants should be allowed to prove a truth-on-the-market defense at that point, in order to avoid certification of meritless class actions. Pet. Br. 20, 24-30, 43-45. But the federal courts are "bound to enforce" Rule 23, and they are not free to supplement or alter its requirements based on their own notions of fairness. *Amchem Prods.*, 521 U.S. at 620-622. The task for a lower court in ruling on a class-certification request is to apply Rule 23 according to its terms, not to devise requirements that the court deems commensurate to the burdens that class certification would place upon the defendant.

Meritorious private securities-fraud actions are "an essential supplement to criminal prosecutions and civil

enforcement actions" brought by the Department of Justice and the SEC. *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007). The policy concerns petitioners raise are properly addressed to Congress, rather than to the courts. In fact, these concerns have been brought to Congress's attention, and Congress has acted on them. In the Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737, Congress responded to perceived abuses in private securities-fraud actions by, *inter alia*, imposing heightened pleading requirements for such actions, 15 U.S.C. 78u-4(b)(1)-(2) (2006 & Supp. IV 2010); mandating an automatic stay of discovery pending resolution of a motion to dismiss, 15 U.S.C. 78u-4(b)(3)(B); creating a safe harbor for forward-looking statements, 15 U.S.C. 78u-5; and making sanctions for abusive litigation mandatory, 15 U.S.C. 78u-4(c). See *Tellabs*, 551 U.S. at 319-322.

Congress then enacted the Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227, which prevented plaintiffs from using state courts to circumvent the protections established in the PSLRA. See *Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, 547 U.S. 71, 80-83 (2006). Thus, Congress already has responded to the concerns petitioners raise, and "the means that Congress chose to deal with settlement pressure were to require more at the pleading stage and to ensure that litigation occurs in federal court under these special standards, rather than state court under looser ones." *Schleicher*, 618 F.3d at 686.

Petitioners are wrong to assert (Br. 24-27) that if they cannot litigate materiality at the class-certification stage, they will be unable to litigate it at all. If, after discovery, respondent cannot adduce evidence from

which a reasonable jury could infer that petitioners' misstatements were material, then petitioners will be entitled to summary judgment. Similarly, a defendant may raise a truth-on-the-market defense before trial. A court may grant summary judgment (or partial summary judgment) when a defendant demonstrates that no rational jury could conclude that the market was misled because the truth had effectively counterbalanced the misstatement. *Schleicher*, 618 F.3d at 687-688.[8] But, absent any sound reason to believe that a plaintiff's ultimate failure to prove materiality will cause individual issues to predominate, it puts "the cart before the horse" to require litigation of that common merits issue before any class can be certified. *Id.* at 687.

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[8] *E.g.*, *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1115-1116, 1119 (9th Cir. 1989) (defendants obtained summary judgment by "conclusively establish[ing] that all material information tending to undermine" the alleged misstatements "had credibly entered the market"), cert. denied, 496 U.S. 943 (1990); *In re Boston Sci. Corp. Sec. Litig.*, 708 F. Supp. 2d 110, 128-129 (D. Mass. 2010) (granting summary judgment because "the market had available sufficient corrective information to cure any arguably misleading statements or omissions"), aff'd, 649 F.3d 5 (1st Cir. 2011); *In re Andrx Corp.*, 296 F. Supp. 2d 1356, 1369 (S.D. Fla. 2003) (granting defendants summary judgment because the truth was "transmitted to the public with a degree of intensity and credibility sufficient to effectively counterbalance any misleading impression created by" the defendants' statements (citation omitted)).

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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SEPTEMBER 2012

APPENDIX

1. 15 U.S.C. 78j provides, in pertinent part:

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

* * * * *

2. 17 C.F.R. 240.10b-5 provides, in pertinent part:

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

* * * * *

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order

to make the statements made, in the light of the circumstances under which they were made, not misleading * * *

* * * * *

3. Federal Rule of Civil Procedure 23 provides, in pertinent part:

Class Actions

(a) **Prerequisites**. One or more members of a class may sue or be sued as representative parties on behalf of all members only if:

(1) the class is so numerous that joinder of all members is impracticable;

(2) there are questions of law or fact common to the class;

(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and

(4) the representative parties will fairly and adequately protect the interests of the class.

(b) **Types of Class Actions**. A class action may be maintained if Rule 23(a) is satisfied and if:

(1) prosecuting separate actions by or against individual class members would create a risk of:

(A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or

(B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;

(2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or

(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:

(A) the class members' interests in individually controlling the prosecution or defense of separate actions;

(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

(D) the likely difficulties in managing a class action.

(c) **Certification Order; Notice to Class Members; Judgment; Issues Classes; Subclasses.**

(1) ***Certification Order.***

(A) *Time to Issue.* At an early practicable time after a person sues or is sued as a class representative, the court must determine by order whether to certify the action as a class action.

(B) *Defining the Class; Appointing Class Counsel.* An order that certifies a class action must define the class and the class claims, issues, or defenses, and must appoint class counsel under Rule 23(g).

(C) *Altering or Amending the Order.* An order that grants or denies class certification may be altered or amended before final judgment.

(2) ***Notice.***

(A) *For (b)(1) or (b)(2) Classes.* For any class certified under Rule 23(b)(1) or (b)(2), the court may direct appropriate notice to the class.

(B) *For (b)(3) Classes.* For any class certified under Rule 23(b)(3), the court must direct to class members the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice must clearly and concisely state in plain, easily understood language:

(i) the nature of the action;

(ii) the definition of the class certified;

(iii) the class claims, issues, or defenses;

(iv) that a class member may enter an appearance through an attorney if the member so desires;

(v) that the court will exclude from the class any member who requests exclusion;

(vi) the time and manner for requesting exclusion; and

(vii) the binding effect of a class judgment on members under Rule 23(c)(3).

(3) ***Judgment.*** Whether or not favorable to the class, the judgment in a class action must:

(A) for any class certified under Rule 23(b)(1) or (b)(2), include and describe those whom the court finds to be class members; and

(B) for any class certified under Rule 23(b)(3), include and specify or describe those to whom the Rule 23(c)(2) notice was directed, who have not requested exclusion, and whom the court finds to be class members.

(4) ***Particular Issues.*** When appropriate, an action may be brought or maintained as a class action with respect to particular issues.

(5) ***Subclasses***. When appropriate, a class may be divided into subclasses that are each treated as a class under this rule.

* * * * *

AMICUS CURIAE BRIEF

RECORD
AND
BRIEFS

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In the Supreme Court of the United States

AMGEN INC., ET AL.
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

On Writ of Certiorari To the United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICUS CURIAE* AARP IN SUPPORT OF RESPONDENT

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INTERESTS OF AMICUS CURIAE[1]

AARP is a non-partisan, non-profit organization dedicated to representing the needs and interests of people age fifty and older. AARP is greatly concerned about fraudulent, deceptive and unfair business practices, many of which disproportionately harm older people. AARP thus supports laws and public policies designed to protect older people from such business practices and to preserve the legal means for them to seek redress. Among these activities, AARP advocates for improved access to the civil justice system and supports the availability of the full range of enforcement tools, including class actions.

A significant percentage of the investing public in the United States' markets is comprised of members of the age fifty and older population.

Older persons are frequent targets of financial fraud because they often have significant assets and they look for investment opportunities that will supplement Social Security and other sources of retirement income. As a result, AARP has elevated the need to combat securities fraud and made this issue a high priority. AARP has regularly commented

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[1] In accordance with this Court's Rule 37.6, no party's counsel wrote this brief in whole or in part and no person other than amici or their counsel made a monetary contribution intended to fund the preparation or submission of the brief. The parties have consented and the parties' letters consenting to the filing of this brief have been lodged with the Clerk of the Court.

on legislative and regulatory proposals that address investment fraud, filed amicus briefs in cases involving the securities laws, and opposed legislative efforts to limit the remedies of defrauded investors.

The resolution of this case will have a significant impact on the integrity of the securities markets and the remediation of securities fraud in those markets. The remediation of securities fraud is of particular concern to AARP at this time. The entry of many first-time investors into the market, the responsibility for retirement investing that pensioners have had to assume as a result of the shift in the retirement plan paradigm from defined benefit pension plans (under which employers bear the risk of loss) to defined contribution pension plans (under which plan participants bear the risk of loss), and the need to protect the interests of small investors in the securities markets are all facets of this issue that greatly impact the financial security of older persons.

SUMMARY OF ARGUMENT

Securities fraud litigation initiated by private parties under the U.S. Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. § 240.10(b) ("Rule 10b-5"), serves as an essential means of protecting the integrity of the securities markets for investors, maintaining investor confidence in the markets, and making victims whole. As the Ninth Circuit recognized, enforcing a materiality requirement at the class certification stage of a class action suit undermines private securities actions in

contravention of *Basic v. Levinson*, 485 U.S. 224 (1988) and Congress's support for securities fraud class action litigation.

Implementing a materiality requirement hurdle at the class certification stage would disproportionately harm small investors, and compromise their role in policing securities fraud. Congress has repeatedly expressed the intent to protect small investors under securities law. To further this intent, Congress has explicitly refrained from limiting the certification of a class action under securities law in order to facilitate remedies for investors who otherwise would have claims too small to litigate. Class action lawsuits including small investors have served a vital role in the deterrence of securities fraud and enforcement of penalties. Amgen's approach would go against precedent and be detrimental to the individuals who most need protection under securities law.

ARGUMENT

I. Requiring Proof of Materiality at the Class Certification Stage in Securities Law Class Actions Would Impose an Unwarranted, Judicially-created Hurdle That Would Hurt Small Investors and Impair the Use of Private Securities Litigation to Enforce Securities Laws.

A. Amgen's proposed approach creates an unnecessary hurdle to class certification that cuts against this Court's precedent, Congress's enactment of securities fraud remedial provisions under Section 10(b), and the SEC's regulatory authority expressed in Rule 10b-5

Class actions serve the important functions of compensation, efficiency, and deterrence. As discussed further in Part I.B., *infra*, where individuals are harmed by a common wrong yet have claims for only small individual amounts, the class action device will often be the only mechanism to compensate those individuals for their losses. *See Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 161 (1974). To the extent that individuals have sufficient losses to bring individual suits, the class action device leads to efficiencies for the courts by consolidating multiple individual claims into one proceeding. *See Am. Pipe Constr. Co. v. Utah*, 414 U.S. 538, 550 (1974). Where they do not, class actions allow individuals to pool their resources and share in

the expense of litigation. *See* Harry Kalven, Jr. & Maurice Rosenfeld, *The Contemporary Function of the Class Suit*, 8 U. Chi. L. Rev. 684, 686 (1941). These efficiencies translate into enhanced compensation for the class. *See* Theodore Eisenberg and Geoffrey P. Miller, *Attorney's Fees and Expenses in Class Action Settlements: 1993-2008*, 7 J. Empirical L. Studies 248, 264 (2010) ("By aggregating smaller claims into a single larger action, economies of scale in legal services are achieved, which can be passed onto class members in the form of enhanced recoveries."). Class actions also deter wrongdoing and supplement governmental enforcement of securities law. "The aggregation of individual claims in the context of a *classwide* suit is an evolutionary response to the existence of injuries unremedied by the regulatory action of government." *Deposit Guar. Nat'l Bank v. Roper*, 445 U.S. 326, 339 (1980).

As for securities fraud class actions, the Court has long recognized the vital importance of legitimate private securities litigation to the federal enforcement regime for securities fraud. *See, e.g.*, *Lampf v. Gilbertson*, 501 U.S. 350 (1991); *Pinter v. Dahl*, 486 U.S. 622 (1988); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985)(observing that "implied private actions are a most effective weapon in the enforcement of the securities laws"); *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964). *See also Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975)(stating that "private enforcement" of Rule 10b-5 is "a necessary supplement to Commission action"). In these and

other decisions, the Court has recognized a strong Congressional policy of favoring private actions as a means of achieving the fundamental goals of our securities laws: fraud deterrence, victim compensation, and the promotion of investor confidence.

A requirement that the named plaintiff prove materiality by a preponderance of the evidence prior to class certification creates an insurmountable hurdle that will close the door to the private securities actions that Congress embraced under Section 10(b) of the Securities and Exchange Act of 1934 and the U.S. Securities and Exchange Commission implemented through Rule 10b-5. This substantial burden of proof results in the trial of Rule10b-5 claims on the merits before discovery is substantially completed or even underway. This result directly contravenes this Court's rationale in *Basic* and imposes severe restrictions on class certification under Rule 10b-5.

It is beyond argument that additional restrictive measures, such as the need to prove materiality during class certification under Rule 10b-5, directly contravene Congress's intent by creating requirements that Congress itself omitted from its enactments. This Court determined the elements for class certification through Rule 23. In enacting the Private Securities Litigation Reform Act of 2005 ("PSLRA"), 15 U.S.C. 78u-4 (2006), and the Securities Litigation Uniform Standards Act ("SLUSA"), 15 U.S.C. § 78a (2006), Congress provided additional requirements for private

securities litigation. These requirements, however, represent the full extent of the hurdles that plaintiffs must overcome in order to certify a class under Section 10(b) and the related Rule 10b-5 and Rule 23. Congress in its lawmaking has recognized the interests that must be balanced in facilitating private securities litigation and plainly addressed these interests through the PSLRA and the SLUSA. Introducing the element of materiality into the class certification process tampers with the balance struck in these statutes and implements a hurdle that Congress chose not to enact.

Limiting the use of private litigation under Rule 10b-5 has serious repercussions, as federal limitations on state law securities fraud claims render 10b-5 plaintiffs' only source of redress. State law offers limited recourse for investors in the Petitioner's position, as Congress has expressly limited the use of class action suits seeking recovery for securities fraud under state law. In 1998, Congress enacted SLUSA to address the concern that "securities class action lawsuits [had] shifted from Federal to state courts" as a means of circumventing the Reform Act. *See* 15 U.S.C. § 78a (findings set forth in Pub. L. 105-353, § 2, Nov. 3, 1998). With certain exceptions, SLUSA provides that no class action based upon state law may be maintained in any state court on behalf of more than 50 class members. *See id.* at § 77p(b). Moreover, state courts generally have not recognized the doctrine of fraud-on-the-market in cases seeking relief under state common law, further limiting the state courts as an alternative forum for investors aggrieved by

misconduct of the sort alleged in this case. *See, e.g.*, *Peil v. Speiser*, 806 F.2d 1154, 1163 (3rd Cir. 1986) (noting that no state has adopted fraud on the market theory); *Kaufman v. i-Stat Corp.*, 754 A.2d 1188, 1193-94 (N.J. 2000); *Mirkin v. Wasserman*, 858 P.2d 568, 584 (Cal. 1993).

Amgen advocates for requiring the plaintiff to demonstrate materiality prior to proceeding on the fraud-on-the-market presumption, and allowing the defendant to present evidence to rebut the presumption. However, requiring proof of materiality at the class certification stage cuts against the Court's interpretation in *Basic* and undermines private securities litigation by adding a prerequisite for class certification that is not part of the plain language of Rule 23.

Basic endorses the fraud-on-the-market presumption on account of the difficulty of proving reliance for each individual class member. Materiality, however, does not share this characteristic. This Court remanded the issue of materiality in *Basic*- proof of materiality did not come into play at class certification. *Basic Inc. v. Levinson*, 485 U.S. 224, 240-41 (1988).

In addition to contravening the underlying rationale in *Basic*, a requirement that the plaintiff establish materiality at the certification stage would create an impermissible hurdle. The named plaintiff would have to demonstrate materiality prior to having the benefit of discovery – a substantial burden, to be sure! Amgen's approach would without

legal or logical warrant, require plaintiffs to undertake a merits inquiry unrelated to class certification prior to having access to full discovery.

The purpose of class certification proceedings is to determine whether the requirements of Rule 23 are met and not to determine whether the plaintiff will be successful on the merits. The office of the fraud on the market theory is to circumvent an unnecessarily burdensome merits inquiry in the class certification process. *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2552 (U.S. 2011). Rule 23 has never stood as an insurmountable bar for plaintiffs by requiring a trial on the merits before discovery is complete and the courts venture out of their proper bounds in erecting such a hurdle. *See Amchem Prods. v. Windsor*, 521 U.S. 591, 620 (1997) (explaining in the context of Rule 23 that "[c]ourts are not free to amend a rule outside the process Congress ordered"). A materiality requirement, however, contravenes the generally understood and previously accepted operative plan of Rule 23 by requiring a series of "mini-trials on the merits of cases at the class certification stage." *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 272 (Dennis, J., dissenting). Rather than permitting the erection of hurdles not previously recognized, this Court should focus on the plain language of Rule 23 and consider whether the plaintiffs satisfied the requirements of the Rule as interpreted by *Basic*. *See Eisen*, 417 U.S. at 177-78. Proof of materiality at the class certification stage is an unnecessary and unwarranted burden for

plaintiffs that serves no legitimate purpose under Rule 23.

Amgen justifies creating a premature materiality proof hurdle to class certification by reasoning that it will reduce the number of frivolous "strike suits" against corporations. However, the problem of frivolous class actions is overstated, given that "economic evidence that strike suits predominate...seems unpersuasive," Michael J. Kaufman & John M. Wunderlich, *The Unjustified Judicial Creation of Class Certification Merits Trials in Securities Fraud Actions*, 43 U. Mich. J.L. Reform 323, 377 (2010), and as scholars have argued and research has supported, "there probably is a stronger correlation between the merits and both the filing and settlement of these actions than critics have claimed." Stefan J. Padfield, *Immaterial Lies: Condoning Deceit in the Name of Securities Regulation*, 61 Case W. Res. 143, 158 (2010)(quoting Donald Langevoort). Congress addressed the concern over class action lawsuits having an in terrorem effect on defendants in the PSLRA. It has subsequently declined to add additional obstacles to class certification. If the Court imposes additional burdens on Rule 23 it will without adequate cause impede one of the "first duties of government": the duty to provide access to courts for meritorious claims. *Marbury v. Madison*, 5 U.S. 137, 163 (1803). Vague protestations about prospects for gains in the integrity of the legal system can hardly justify the shuttering of the courthouse door to plaintiffs with legitimate securities fraud claims.

B. Requiring Materiality at Class Certification Will Hurt Small Investors, a Group Securities Laws Were Designed to Protect

Class action lawsuits have been recognized as an irreplaceable tool for individuals with small claims and protecting these individuals has been a goal of securities law since its inception. Without the class action mechanism, small investors who suffer losses will effectively be left without access to any remedy for companies' fraudulent conduct.

Class actions favor small investors because they aggregate small claims that are not viable on their own. Individual investors' losses are invariably smaller than attorneys' fees in an individual securities fraud action. Class actions are an effective tool that enables these small investors to attract competent legal counsel by aggregating the fees they may recover. Louis Loss & Joel Seligman, *Securities Regulation* 4626-27 (3rd ed. 2005). A policy recognizing the power of strength in numbers to recover on these small claims is "at the very core of the class action mechanism." *Mace v. Van Ru Credit Corp.*, 109 F. 3d 338, 344 (7th Cir. 1997). When Rule 23(b)(3) was enacted Congress "expected [the rule] to be particularly helpful" to individuals with small claims by allowing them "to combine their resources and bring an action to vindicate their collective rights." Arthur R. Miller, *Problems in Administering Judicial Relief in Class Actions Under Federal Rule 23(b)(3)*, 54 F.R.D. 501, 502 (1975); *see also Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 617

(1997)(observing that although cases where individual damages are substantial are not excluded by the text of Rule 23(b)(3), "the Advisory Committee had dominantly in mind vindication of 'the rights of groups of people who individually would be without effective strength to bring their opponents into court at all'"). Notably, while the Supreme Court restricted the opportunity for small claimants to certify as a class it has not so limited cases addressing antitrust and securities laws. Arthur R. Miller, *Problems in Administering Judicial Relief in Class Actions Under Federal Rule 23(b)(3)*, 54 F.R.D. 501, 503 (1975). Undermining class actions would remove the historically favored power of small investors, authorized and favored by Congress, to combat securities fraud through private litigation.

If materiality is reviewed as early in the litigation process as Amgen advocates, the practical result will be that plaintiffs will not be able to rise to the demand to demonstrate materiality because of the lack of discovery opportunities as of that stage. Plaintiffs will have incomplete resources to meet their burden and their expenses will increase greatly. Class actions will become more difficult to bring relative to individual actions. Inevitably, the incentive for small investors to bring litigation to police the market will be greatly reduced.

If achieving class certification becomes more burdensome, institutional investors may tend to bring individual actions rather than class actions, and small investors' interests will be denied representation altogether. *See Eisen*, 417 U.S. at 186

(1974)(remarking that "[t]he class action is one of the few legal remedies the small claimant has against those who command the status quo"). While institutional investors may bring individual actions, this is not an option for those small or individual investors "whose claims may seem *de minimus* but who alone have no practical recourse for either remuneration or injunctive relief." *Eisen v. Carlisle and Jacquelin*, 417 U.S. 156, 186. Institutional investors already make up a large percentage of the lead plaintiffs in securities class actions because of policy considerations behind the PSLRA. David H. Webber, *Is "Pay-to-play" Driving Public Pension Fund Activism In Securities Class Actions? An Empirical Study*, 90 B.U.L. Rev. 2031, 2036-38 (2010). Congress encouraged the use of institutional investors as lead plaintiffs rather than plaintiffs attorneys because it believed those investors were more likely to have interests aligned with all investors. *Id.* The greater the incentive for institutional investors to bring individual actions, the less incentive for institutional investors to act in the interest of small investors and likewise the less likelihood that small investors will recover their losses. Undermining class actions would tilt securities fraud law even more strongly toward the interests of large investors and inhibit the recovery of small investors, creating an inequality of recovery for equal injury. The potential effect of this injury on small investors, particularly older investors, is especially compelling given the percentage of their income that comes from investments. In 2010, income from assets comprised 11.8 % of the total income of individuals aged 65 and older. Employee

Benefit Research Institute, *EBRI Databook on Employee Benefits Chapter 7: Sources of Income for Persons Aged 55 and Over* (Nov. 2011), *available at* http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2007.pdf. The PSLRA sets a ceiling rather than a floor as to the burdens that Congress intended to be cast upon small investor plaintiffs. Amgen's position seeks to stretch the PSLRA beyond Congress's initiative. A regime incentivizing institutional investors to bring individual actions instead of class actions would permit large institutional investors to recover where small investors cannot, for precisely the same injury caused by the same fraudulent conduct. This scenario amounts to an all-out assault on small investor interests.

If institutional investors bring individual cases rather than joining class actions, individual investors and small investors will suffer losses from their lack of protection. This scenario brings no integrity to the legal system. Congressional initiatives to promote enforcement of the securities laws do not point in this direction either. Given the nature of the public securities markets and prevailing practices pertaining to investment in securities, large investors are more likely to have any loss due to fraud offset by gains on shares of other stock with temporarily inflated prices due to undisclosed fraud. John D. Glater, *Critics of Shareholder Suits Aim at Big Holders*, N.Y. Times (Oct. 27, 2005), http://www.nytimes.com/2005/10/27/business/27suit.html?_r=0. Smaller investors are predictably less likely to have stock holdings as diverse as those of

large investors and therefore they are at greater risk for loss from securities fraud. *Id.* These individuals are "exposed to a greater risk from securities fraud because they lack the natural 'hedge' that exists within large, diversified portfolios." Anjan V. Thakor, Ph.D., *The Economic Reality of Securities Class Action Litigation*, Abstract (2005). Precluding small investors from making use of class actions in securities fraud cases therefore hurts investors in addition to undermining enforcement of securities laws through private litigation.

If the public investment markets are to remain accessible to small investors, protecting access by small investors to the class action mechanism as a means of redressing fraudulent market conduct by securities issuers is essential.

CONCLUSION

For all of the foregoing reasons, amicus respectfully submits that the decision of the Ninth Circuit should be upheld.

Respectfully submitted,

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AMICUS CURIAE BRIEF

RECORD AND BRIEFS

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AMGEN INC., ET AL.,

Petitioners,

—v.—

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF *AMICI CURIAE* CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM AND CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM IN SUPPORT OF RESPONDENT

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INTEREST OF THE *AMICI CURIAE*

This brief is filed on behalf of public pension systems that serve as fiduciaries to public employees who rely on them to prudently manage their retirement funds.[1] These public funds have a special responsibility to help ensure the accountability of participants in the securities markets, and therefore a strong interest in the integrity of, and eliminating fraud in, such markets.

The California Public Employees' Retirement System ("CalPERS") is the largest state public pension fund in the United States. CalPERS manages approximately $205 billion on behalf of 1.6 million California public employees, retirees and their families. The California State Teachers' Retirement System ("CalSTRS") manages an approximately $138.5 billion fund to administer retirement, disability, and survivor benefits for California's 845,000 public school educators and their families.[2]

The *amici* believe that Rule 23 of the Federal Rules of Civil Procedure should be applied to cases

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[1] Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part and that no person other than *amici* and their counsel made a monetary contribution to its preparation or submission. Blanket consent to the filing of *amicus* briefs was given by the parties and filed with the Clerk's office.

[2] According to the U.S. Census Bureau's 2010 Statistical Abstract, state and local retirement funds had $2.311 trillion in assets in 2008 ($1.238 trillion in corporate equities). U.S. Census Bureau, Assets of Private and Public Pension Funds (2009), available at http://www.census.gov/compendia/statab/2010/tables/10s1180.xls.

involving claims under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), in a manner that will help to promote Congress's intent to provide redress for misrepresentations and deceptive practices in the purchases and sales of securities. The *amici's* overriding responsibility is to provide for the payment of benefits to their members and, in doing so, to invest for the long-term security of their millions of active and retired members. As major investors with long-term outlooks, the *amici* are vitally concerned with the proper and efficient functioning of U.S. capital markets and are concerned that investors not be harmed by fraudulent conduct. Many state and local governments are constitutionally obligated to guarantee defined benefit retirement plans. Therefore, investment losses due to securities fraud fall directly on state and local governments, and ultimately on taxpayers. If the ability of public pension funds to recover money lost to securities fraud is impaired, the public will suffer.

In recent years, public pension funds have become increasingly concerned about the integrity of U.S. securities markets. Scandals at Enron, WorldCom, Global Crossing, Tyco, Refco, Fannie Mae, Freddie Mac, Adelphia, Xerox, and numerous other public companies have caused hundreds of billions of dollars in losses to innocent investors. As investors who have been materially harmed by corporate fraud, the *amici* have a strong interest in ensuring that the law allows injured investors to recover from perpetrators of fraud.

The *amici* strongly believe that investors' ability to redress corporate wrongdoing through private

actions—including in particular through class actions—under the Securities Exchange Act of 1934 is essential to deter improper conduct and to recoup losses caused by fraud. As this Court noted in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 320-21 n.4 (2007) (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006)), "private securities litigation is an indispensable tool with which defrauded investors can recover their losses—a matter crucial to the integrity of domestic capital markets." Indeed, with the enactment of Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (1995) ("PSLRA"), Congress sought "to increase the likelihood that institutional investors will serve as lead plaintiffs," based on its belief "that increasing the role of institutional investors in class actions will ultimately benefit shareholders and assist courts by improving the quality of representation in securities class actions." H.R. Rep. No. 104-369, at 34 (1995) (Conf. Rep.).

SUMMARY OF ARGUMENT

The Court of Appeals' decision that Respondents, having established the existence of an efficient market, need not also prove at the class certification stage the materiality of Petitioners' alleged misstatements is wholly consistent with this Court's precedent, the logic of the fraud-on-the-market presumption and the structure of the Rule 23 class action. As this Court held in *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974), and *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551 (2011), the question that must be resolved at the class certification stage is not

whether the plaintiffs' claims should prevail, but rather, whether those claims are susceptible to classwide proof. Provided that the plaintiff has met all applicable pleading burdens under the PSLRA, Rule 9(b) and *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), any merits issues that involve common issues that predominate as to all class members—such as whether defendants' statements in a fraud case are "material"—should be considered only insofar as necessary to meet the expressly delimited criteria for resolving class certification issues under Rule 23, and must otherwise be resolved only at summary judgment or trial. To do otherwise would be to improperly conflate resolution of *procedural* Rule 23 issues with well-established means for addressing merits issues that already exist at both the early pleading and later summary judgment and trial stages of litigation.

In a securities fraud case, the materiality of the alleged misstatements and omissions is a fact-intensive merits question. The answer depends upon a broad array of factors, both quantitative and qualitative, including the magnitude of the issues in the context of the company's overall operations and management's state of mind in making the alleged misstatements or omissions. *See Basic Inc. v. Levinson*, 485 U.S. 224, 238-39 (1988). This Court, Congress, the Securities and Exchange Commission ("SEC"), and the accounting profession have all recognized that the materiality test must be flexible if it is to be effective, and that a more rigid rule would be underinclusive, overinclusive, or both. However, because the test for materiality is objective, and looks to what

the hypothetical "reasonable investor" would have thought, it is a test particularly well-suited to classwide proof.

The broad factual inquiry that is frequently necessary to resolve materiality disputes is simply not suitable for resolution at the class certification stage. As Judge Easterbrook, one of the leading exponents of the fraud-on-the-market presumption, has stated, once the plaintiffs have proven the existence of an efficient market, the defense argument that their alleged misrepresentations were inconsequential goes to whether plaintiffs have a *claim* on the merits, and not whether they have a claim that can be brought as a *class action* under Rule 23. *See Schleicher v. Wendt*, 618 F.3d 679, 685-87 (7th Cir. 2010). Similarly, this Court held only last year that the question of what actually caused the plaintiffs' losses is not a matter to be resolved at class certification, as the answer to that question (like questions about materiality) will be the same for all class members so long as the market is efficient. *See Erica P. John Fund. v. Halliburton Co.*, 131 S. Ct. 2179, 2185-86 (2011). Although Defendants and their *amici* now try to couch some of their materiality concepts in terms of requiring proof of "price impact," whether such questions are framed in terms of "loss causation" or "materiality" makes no difference, since the outcome of such merits inquiries will necessarily be the *same* for all class members.

Finally, it should be stressed that Petitioners' legally misguided efforts to make class certification decisions more closely resemble merits decisions will inevitably deter institutional investors such as *amici* from seeking to assert claims on a

classwide basis. If obtaining class certification not only involves the traditional Rule 23 inquiries of commonality, typicality, adequacy, and superiority, but *also* requires largely the same proofs and burdens as obtaining individual relief, any investors with a sufficient stake to pursue individual claims will have an incentive to cut to the chase and avoid the class certification inquiry entirely. This would have the practical effect of atomizing securities fraud litigation into a multiplicity of solo actions asserted by institutional investors, with class actions being led by smaller investors who could not economically bring individual claims. This is exactly what Congress sought to avoid when it passed the PSLRA.

ARGUMENT

MATERIALITY IS A FACT-INTENSIVE INQUIRY THAT SHOULD NOT BE RESOLVED AT THE CLASS CERTIFICATION STAGE

A. The Class Certification Inquiry Is Limited To The Question Of Whether Plaintiffs Will Prove Their Case Using Common, Classwide Evidence

In conducting a certification analysis, the district court's role is not to assess the merits of the case, but only to determine whether questions of law or fact capable of resolution through common evidence predominate over individual questions. *See Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974). The focus of class certification is "the capacity of a classwide proceeding to generate

common *answers* apt to drive the resolution of the litigation." *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. at 2551 (quoting Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 132 (2009)) (emphasis in original). As the Ninth Circuit Court of Appeals correctly noted in the decision on appeal herein, "the critical question in the Rule 23 inquiry" is not whether the plaintiffs' claims would survive a motion to dismiss, but rather, whether "the plaintiffs' claims stand or fall together." 660 F.3d 1170, 1175 (9th Cir. 2012). "The chance, even the certainty, that a class will lose on the merits does not prevent its certification." *Schleicher*, 618 F.3d at 685.

Because the class certification inquiry is circumscribed to determining the *types* of evidence that would ultimately be used to determine the plaintiffs' claims, as opposed to the *contents* of that evidence—and because Rule 23(c)(1)(A) mandates that class certification decisions be made "[a]t an early practicable time"—the scope of class certification discovery is appropriately limited to examining the types of information that will be integral to any later adjudication of the case at summary judgment and trial. As the Advisory Committee Notes to Rule 23 state,

> Although an evaluation of the probable outcome on the merits is not properly part of the certification decision, discovery in aid of the certification decision often includes information required to identify the nature of the issues that actually will be presented at trial. In this sense it is appropriate to conduct controlled discov-

> ery into the "merits," limited to those aspects relevant to making the certification decision on an informed basis. . . . A critical need is to determine how the case will be tried. An increasing number of courts require a party requesting class certification to present a "trial plan" that describes the issues likely to be presented at trial *and tests whether they are susceptible of class-wide proof.*

Advisory Committee Notes to the 2003 amendments to Rule 23(c)(1)(A) (emphasis added); *see also* MANUAL FOR COMPLEX LITIGATION, FOURTH ED., § 21.14 ("Generally, discovery into certification issues pertains to the requirements of Rule 23 and whether the claims and defenses are susceptible to class-wide proof[.]"); *In re Zurn Pex Plumbing Products Liability Litig.*, 644 F.3d 604, 613 (8th Cir. 2011) ("As class certification decisions are generally made before the close of merits discovery, the court's analysis is necessarily prospective and subject to change, and there is bound to be some evidentiary uncertainty."); *Messner v. Northshore University Health System*, 669 F.3d 802, 823 (7th Cir. 2012) ("[I]t is unlikely that discovery regarding the merits of a claim will be complete by the time the court is called upon to certify a class."). In other words, while the preliminary inquiry at the class certification stage

> may overlap the merits of the case . . . such disputes may be resolved only insofar as resolution is necessary to determine the nature of the evidence that would be sufficient, if the plaintiff's general allegations were true, to make out a prima facie

> case for the class. The closer any dispute at the class certification stage comes to the heart of the claim, the more cautious the court should be in ensuring that it must be resolved in order to determine the nature of the evidence the plaintiff would require.

Blades v. Monsanto Co., 400 F.3d 562, 562 (8th Cir. 2005); *see also In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 16 (1st Cir. 2005) (noting that courts must not turn the class-certification proceeding "into a mini-trial on the merits"); *Unger v. Amedisys, Inc.*, 401 F.3d 316, 321 (5th Cir. 2005) ("Class certification hearings should not be mini-trials on the merits of the class or individual claims"). Accordingly, as the Seventh Circuit has held with respect to materiality, "whether statements were false, or whether the effects were large enough to be called material, are questions on the merits." *Schleicher*, 618 F.3d at 685 (internal citations omitted). While a court "may take a peek at the merits before certifying a class", this peek must "be limited to those aspects of the merits that affect the decisions essential under Rule 23." *Id.*

For these and other reasons, recent scholarship has expressed concern over the trend towards converting certification decisions into mini-trials. *See* Joshua P. Davis & Eric L. Cramer, *Antitrust, Class Certification, and the Politics of Procedure*, 17 Geo. Mason L. Rev. 969, 969 (2010) (arguing that the resolution of merits questions at the certification stage could "wreak havoc with the orderly administration of litigation" by requiring premature resolution of merits issues or belated

certification rulings, and also risks violating the Seventh Amendment); Michael J. Kaufman & John M. Wunderlich, *The Unjustified Judicial Creation of Class Certification Merits Trials in Securities Fraud Actions*, 43 U. Mich. J. L. Reform 323, 323 (2010) (judicial resolution of merits at the certification stage is inconsistent with federal securities laws and Supreme Court precedent, infringes on the Seventh Amendment, and causes significant harm to plaintiffs while serving no legitimate policy concerns); Steig D. Olson, *"Chipping Away": The Misguided Trend Toward Resolving Merits Disputes as Part of the Class Certification Calculus*, 43 U.S.F. L. Rev. 935, 936 (2009) (those courts making summary judgment-like decisions at the class certification stage "fundamentally misapprehend the proper role of the certification decision, which is to shape the litigation based on an evaluation of how the plaintiffs intend to prove their case.").

It is also worth noting that Congress has long had the ability to add a merits inquiry to the Rule 23 certification analysis, but has declined to do so. *See* Olson, 43 U.S.F. L. Rev. at 938 ("Following *Eisen*, various parties have made proposals (formally and informally) to revise Rule 23 to allow for preliminary evaluation of the merits of the plaintiffs' claims, but these efforts never succeeded."). Instead, when Congress chose to reform the securities class action through the passage of the PSLRA and Securities Litigation Uniform Standards Act,[3] it chose to do so primarily by establishing heightened pleading standards and

[3] Pub. L. No. 105–353, 112 Stat. 3227 (1998).

controlling the forums in which class actions may be brought, and not by enacting additional barriers to class certification. *See Schleicher*, 618 F.3d at 686 ("[T]he means that Congress chose to deal with settlement pressure were to require more at the pleading stage. . . . We do not think it appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits."); Kaufman & Wunderlich, 43 U. Mich. J. L. Reform at 344-50 (discussing how, at the time Congress enacted the PSLRA to address concerns over securities litigation, it did not establish heightened class certification standards).

Indeed, the PSLRA expressly provides an avenue by which defendants can seek to have meritless materiality allegations dismissed. Specifically, the PSLRA contains a safe harbor provision which applies to forward-looking statements that are not material. *See* 15 U.S.C. § 78u-5(c)(1)(A)(ii). Accordingly, courts can and do dismiss securities cases where plaintiffs have alleged nothing more than mere puffery or general statements of corporate optimism. *See, e.g., Indiana State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. OmniCare, Inc.*, 583 F.3d 935, 944 (6th Cir. 2009); *In re Lincoln Educational Services Corp. Sec. Litig.*, No. 10-cv-460, 2011 WL 3912832, at *8 (D.N.J. Sept. 6, 2011); *In re Impac Mortg. Holdings, Inc. Sec. Litig.*, 554 F. Supp. 2d 1083, 1096-98 (C.D. Cal. 2008). In the context of their motion to dismiss, Petitioners have already had an opportunity to contest the materiality of their alleged misstate-

ments and omissions. *See In re Amgen, Inc. Sec. Litig.*, 544 F. Supp. 2d 1009, 1027 (C.D. Cal. 2008). For them to claim a second bite at the apple in the class certification hearing would disrupt the balance between investor rights and issuer protections that Congress has deliberately set.

B. Materiality Is A Contextual, Fact-Intensive Merits Inquiry

This Court, Congress, the SEC and even the accounting profession have all recognized that whether a particular misrepresentation or omission is "material" is not a question that can be adequately resolved through any simple, bright-line tests. Rather, assessing materiality involves a highly contextual inquiry that must take all surrounding facts and circumstances into account—thus making it particularly inappropriate for resolution before full discovery.

Significantly, however, materiality is also an objective inquiry that looks to what the hypothetical "reasonable investor" would have thought based on all relevant facts and circumstances, such that if a statement is material as to one investor, it is material to *all* investors. Accordingly, the materiality inquiry is well-suited to resolution on a class basis, because the merits of each class member's materiality claims will involve exactly the same evidence. Petitioners do not and cannot dispute that the materiality of the misstatements and omissions alleged in the Complaint are susceptible to class-wide proof. *See Schleicher*, 618 F.3d at 685. ("Falsehood and materiality affect investors alike.").

In *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), this Court explained that within the context of the Securities Exchange Act of 1934, proving materiality requires "a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable investor." *Id.* at 449. For the disclosure of an omitted fact to be material, it must have been a fact that the reasonable investor would have viewed as significantly altering the "total mix" of information made available. *Id.*[4] This determination is a mixed question of law and fact, requiring "delicate assessments" of the inferences to be drawn from a given set of facts and the significance of those inferences, and as such, the assessment of whether a particular omission or misrepresentation is material is usually one for the trier of fact. *Id.* at 450.

This Court adopted the *TSC Industries* materiality standard for § 10(b) claims in *Basic Inc. v. Levinson*, 485 U.S. 224, 232 (1988). In doing so, the Court rejected the use of mechanical, bright-line tests to assess materiality, noting that, "[a]ny approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive." *Id.* at 236. The Court further noted that its construction of the word "material" aligned with Congress's intent, citing the Congressional Advisory

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[4] It is not, however, necessary to allege or prove that the investor would have acted differently if an accurate disclosure was made. *See id.* at 449.

Committee on Corporate Disclosure's statement that:

> Although the Committee believes that ideally it would be desirable to have absolute certainty in the application of the materiality concept, it is its view that such a goal is illusory and unrealistic. The materiality concept is judgmental in nature and it is not possible to translate this into a numerical formula. The Committee's advice to the [SEC] is to avoid this quest for certainty and to continue consideration of materiality on a case-by-case basis as disclosure problems are identified.

Id. at 236 n.14 (quoting House Committee on Interstate and Foreign Commerce, Report of the Advisory Committee on Corporate Disclosure to the SEC, 95th Cong., 1st Sess., 327 (Comm. Print 1977)).

Basic held that with respect to contingent or uncertain information or events (such as the clinical trial results at issue in this case), materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in the light of the totality of the company activity," a question it described as "highly fact-dependent." *Id.* at 238-39 (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968)). "Materiality depends on the facts and thus is to be determined on a case-by-case basis." *Id.* at 250.

Following *Basic*, courts "have consistently rejected a formulaic approach to assessing the materiality of an alleged misrepresentation." *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 162

(2d Cir. 2000); *see, e.g., United States v. Smith*, 155 F.3d 1051, 1064-66 (9th Cir. 1998) (under *Basic*, even "soft" statements regarding forward-looking data and projections may be material). In particular, reliance on a "numerical or percentage benchmark to determine materiality" is "error." *Ganino*, 228 F.3d at 162.

This Court's recent decision in *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011), reaffirmed *Basic*'s holding that materiality cannot be adequately assessed through a bright-line test. *See id.* at 1318-19. The Court again noted that materiality is a fact-specific inquiry, holding that determining the materiality of adverse event reports "requires consideration of the source, content, and context of the reports," and that "[t]his contextual inquiry may reveal in some cases that reasonable investors would have viewed reports of adverse events as material even though the reports did not provide statistically significant evidence of a causal link." *Id.* at 1321.

The SEC has also formally agreed that the materiality inquiry is complex and contextual. For example, in the accounting context, the SEC has stated:

> Materiality concerns the significance of an item to users of a registrant's financial statements. The omission or misstatement of an item in a financial report is material if, in light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.

Staff Accounting Bulletin No. 99, 17 C.F.R. § 211, 64 F.R. 45150 (Aug. 19, 1999) ("SAB 99").[5] Under SAB 99, "[m]ateriality has both a quantitative and a qualitative component, and it is error to rely exclusively on a single numerical or percentage benchmark to determine materiality." *SEC v. Escala Group, Inc.*, No. 09-cv-2646, 2009 WL 2365548, at *9 (S.D.N.Y. 2009).

It is necessary that the standard be flexible and open-ended because, "the authoritative accounting literature cannot specifically address all of the novel and complex business transactions and events that may occur." *Id.*[6] Some of the factors that the SEC has identified as being relevant to

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[5] Materiality is defined in a similar manner throughout SEC regulations. *See, e.g.*, Rule 1-02(o) of Regulation S-X, 17 CFR § 210.1-02(o) ("The term material, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters about which an average prudent investor ought reasonably to be informed."); Rule 405 of Regulation C, 17 CFR § 230.405 ("The term material, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."); Rule 12b-2, 17 CFR § 240.12b-2 ("The term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered.").

[6] *See also* Arthur Levitt, Chairman, Sec. & Exch. Comm., Remarks at the NYU Center for Law and Business (Sept. 28, 1998), available at http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt ("Materiality is another way we build flexibility into financial reporting.").

the materiality analysis in the accounting context include whether the misstatement is an estimate or an item capable of precise measurement, whether the misstatement masks a change in earnings or other trends, whether the misstatement concerns an especially important segment of the registrant's business, and whether the misstatement affects the registrant's compliance with regulatory requirements. *See id.* As SAB 99 states, "quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations." *Id.*

Lower courts have found SAB 99 to provide "persuasive guidance for evaluating the materiality of an alleged misrepresentation" in the financial disclosure context. *Ganino*, 228 F.3d at 163; *see also ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase & Co.*, 553 F.3d 187, 197-98 (2d Cir. 2009) ("[A]ccording to SAB 99, both quantitative and qualitative factors should be considered in assessing a statement's materiality."); *In re SLM Corp. Sec. Litig.*, No. 08-cv-1029, 2012 WL 209095, at *7 (S.D.N.Y. Jan. 24, 2012) (under SAB 99 and Supreme Court precedent, courts must apply "a common-sense and holistic approach" to materiality); *SEC v. Kovzan*, 807 F. Supp. 2d 1024, 1045 (D. Kan. 2011) (SAB 99 "indicates that *any factors* relating to a misstatement's materiality should also be considered.") (emphasis added).

The accounting profession also recognizes that materiality depends on context and resists bright-line rules. *See* Financial Accounting Standards

Board ("FASB") Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting ("Concepts Statement No. 8"), QC11 (Sept. 2010) ("Information is material if omitting it or misstating it could influence decisions that users make . . . . In other words, materiality is . . . based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity's financial report.") Accordingly, like the SEC, the FASB directs financial management and auditors to assess both "quantitative" and "qualitative" factors in assessing an item's materiality. *Compare* SAB 99 *with* Concepts Statement No. 8 QC11.

The qualitative factors necessary to make materiality determinations may include inquiries into the mental states of executives and management. For example, when a plaintiff alleges that a statement of opinion or belief constituted a material misrepresentation, the finder of fact may need to examine the subjective opinions held by management. *See, e.g., Grossman v. Novell, Inc.*, 120 F.3d 1112, 1119 n.6 (10th Cir. 1997) (noting that it is "quite clear" that statements of opinion may be material "if the opinion is known by the speaker at the time it is expressed to be untrue or to have no reasonable basis in fact."); *In re Computer Sciences Corp. Sec. Litig.*, No. 11-cv-610, 2012 WL 3779349, at *13 (E.D. Va. Aug. 29, 2012) ("[A] reasonable investor surely would have considered it important that CSC's own on-the-ground analysts did not believe CSC could meet critical contractual deadlines . . . ."); *United States v. Causey*, No. 04-cv-25, 2005 WL 2647976, at *12 (S.D. Tex. Oct. 17,

2005) (examining defendant's knowledge that a statement regarding Enron's auditing was false in determining that the statement was material).

A further example of the type of non-quantitative considerations that enter into the materiality analysis may be seen in the cases that consistently hold that the integrity of management "is always a material factor." *In re Franchard Corp.*, 42 S.E.C. 163, 172 (1964); *see also, e.g., Siemers v. Wells Fargo & Co.*, No. 05-cv-04518 WHA, 2007 WL 1140660, at *8 (N.D. Cal. Apr. 17, 2007) ("The integrity of management is always of importance to investors."); *SEC v. Jos. Schlitz Brewing Co.*, 452 F. Supp. 824, 830 (E.D. Wisc. 1978) ("[T]he question of the integrity of management gives materiality to the matters the [SEC] claims should have been disclosed."); *Ross v. Warner*, No. 77-cv-243, 1980 WL 1474, at *8, (S.D.N.Y. Dec. 12, 1980) ("nondisclosure of . . . questionable payments was material" because it is "pertinent to the integrity of management."). The SEC has also stated that "[w]hile the intent of management does not render a misstatement material, *it may provide significant evidence of materiality*." SAB 99 (emphasis added). The facts relevant to an analysis of the integrity of management often will be complex and will rarely be susceptible to thorough analysis at class certification (not least because the depositions of a corporate defendant's most senior officers invariably occur at the end, rather than towards the beginning, of discovery).

Finally, materiality cannot be boiled down to a simple analysis of whether the stock price moved in reaction to the announcement. *Amici* argue that "[t]he only important question is whether the

price was distorted." Brief of Law Professors as *Amici Curiae* In Support Of Petitioners at 9 (quoting Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. Pa. L. Rev. 851, 898-99 (1992)). As pointed out in *SLM Corp.*, 2012 WL 209095, at *5 (internal citations omitted), this argument

> . . . confuses "economic materiality" with the meaning of materiality under the securities laws. . . . "[M]ateriality has a specific meaning for economists, who use scientific methods to determine whether a misrepresentation or omission impact[ed] the stock price in a significant fashion. A legal assessment of materiality is different—it is not determined by a single factor, such as price impact, but must take into account all the relevant circumstances in a particular case.

Similarly, the SEC has appropriately rejected the idea that the market reaction to a corrective disclosure is, in and of itself, an adequate test for materiality, stating: "Consideration of potential market reaction to disclosure of a misstatement is by itself too blunt an instrument to be depended on in considering whether a fact is material." SAB 99 (internal quotations omitted).

Moreover, the very scholar upon whom *amici* rely squarely *opposes* their suggested focus on "price impact." Professor Langevoort has acknowledged that event studies "simply do not produce clean results when there are two or more simultaneous issuer-specific events being measured over a short time horizon." Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009

Wisc. L. Rev. 151, 187 (2009).[7] As such, "one could imagine a truly dastardly fraud where the class certification is denied simply because the company announced additional bad news along with its acknowledgment of wrongdoing," thereby confounding easy efforts to disentangle the extent to which any "price impact" was due to factors relating to disclosures of the fraud as opposed to "unrelated" disclosures. *Id.* at 195.[8] This problem is likely to be especially acute in instances where a significant amount of time has passed between the misstatement or omission and the corrective disclosure, such that the company's overall position has changed. For example, if a company releases false information regarding one of its products in 2011, and then corrects the misinformation a year later when it announces the release of a new and improved version of the product, it will be very difficult to determine how the stock price would have moved differently had the company been truthful all along.[9]

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[7] *Amici* cite to Professor Langevoort only to put his views into proper context, and not to endorse every aspect of his analysis of Rule 23 or *Basic*.

[8] Alternately, the issuer could reveal its fraud on a day where it announces generally positive news, such that at the time of class certification, the district court would be faced with the extremely difficult task of determining how much the stock price would have otherwise risen.

[9] In the damages context, Judge Easterbrook and Professor Daniel Fischel have discussed some of the limitations that may confound event studies, including that event studies lose accuracy as the interval over which they are performed increases, that intervening events "may be hard to untangle," that information may trickle out over a long period of time, and that "[t]he method assumes a particular form of relation

Indeed, the Court addressed this evidentiary problem in *Basic* itself, stating that, "[r]equiring a plaintiff to show a speculative state of facts . . . would place an unnecessarily unrealistic evidentiary burden on the Rule 10b-5 plaintiff who has traded on an impersonal market." 485 U.S. at 245. The *Basic* Court emphasized that in adopting its presumption of reliance, it did not intend to "determine by adjudication what economists and social scientists have debated through the use of sophisticated statistical analysis and the application of economic theory." *Id.* at 246 n.24. Rather, the presumption arises "out of considerations of fairness, public policy, and probability, as well as judicial economy." *Id.* at 245. This Court recently reaffirmed *Basic* in *Erica P. John Fund v. Halliburton*, 131 S. Ct. at 2186, holding that a plaintiff need not prove what caused its losses "to establish the efficient market predicate to the fraud-on-the-market theory."

A retrospective materiality test at the class certification stage that is focused wholly on market reaction would invite abuse by unscrupulous issuers. On the front end, since many frauds involve issuers who seek to fraudulently maintain prior market expectations, the false statements in such cases would not be expected to "surprise" the market or result in a noticeable price impact when made.[10] On the back end, artful issuers could con-

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between the market and individual stocks that is necessarily an oversimplification." Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages In Securities Cases*, 52 U. Chi. L. Rev. 611, 628 (Summer 1985).

[10] *See, e.g., In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 561-62 (S.D.N.Y. 2011); *Credit Suisse-AOL, In re Credit Suisse-AOL Sec. Litig.*, 465 F. Supp. 2d 34, 44, 54-56 (D.

found event studies by slowly leaking bad news over time, or strategically timing their corrective disclosures alongside other important news. A test that renders market price reaction the *sine qua non* of materiality would provide no comfort to honest issuers, and would be so one-dimensional and mechanical that the dishonest could easily manipulate it.

Given these considerations, courts have rejected arguments that asserted misrepresentations "were not material because the price of the [defendant's] securities did not suffer a statistically significant market reaction as a result of the Corrective Disclosures." *In re Alstom SA Sec. Litig.*, 253 F.R.D. 266, 279 (S.D.N.Y. 2008) (citing *Basic*, 485 U.S. at 231-32). Under *Basic*, "[t]here is no requirement that stock prices fluctuate as a result of a defendant's misstatements or omissions in order for them to be material." *SEC v. DCI Telecommunications, Inc.*, 122 F. Supp. 2d 495, 499 (S.D.N.Y. 2000). *See also No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d 920, 934 (9th Cir. 2003); *In re Take-Two Interactive Sec. Litig.*, 551 F. Supp. 2d 247, 291-92 (S.D.N.Y. 2008); *SEC v. Penthouse Int'l, Inc.*, 390 F. Supp. 2d 344, 353 (S.D.N.Y. 2005).[11]

Mass 2006);); *In re Bristol-Myers Squibb Sec. Litig.*, No. 00-cv-1990, 2005 U.S. Dist. LEXIS 18448, at *47-48 (D.N.J. Aug. 17, 2005).

[11] *But see In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) (information is immaterial if the disclosure of that information has no effect on the company's stock price). *Burlington* dealt with a motion to dismiss and so is not directly applicable here. In all events, as one commentator has observed, "the [*Burlington*] court is

Some kind of "price impact" will be evident in almost every securities fraud case, since plaintiffs will rarely initiate suit if the price of the company has remained stable. The distinction between "price impact" and materiality primarily comes into play in cases (such as this one) where there has been a noticeable drop in the company's stock price, but the parties contest what was responsible for that drop. In this context, stock price movements and event studies are an important component of the materiality analysis, but they do not and cannot substitute for a more nuanced and contextual analysis that also takes other considerations relevant to materiality into account. "Evidence of stock price movement may be relevant to the issue of materiality but it is not determinative." *Geiger v. Solomon-Page Group*, 933 F. Supp. 1180, 1188 (S.D.N.Y. 1996). Since no bright-line test could adequately capture the "delicate assessments" that the materiality inquiry demands, materiality is (and must be) a broad and fact-intensive issue, such that the contours of the inquiry and the relevant proofs will vary considerably from case to case. *See Basic*, 485 U.S. at 250.

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invoking a questionable heuristic in a number of respects . . . if the court is willing to look at nothing more than market reaction, plaintiffs probably lose what could be an otherwise strong case." Langevoort, 2009 Wisc. L. Rev. at 190; *see also No. 84 Employer-Teamster Joint Council*, 320 F.3d at 934 (declining to adopt a per se rule that if there has been no immediate change in the stock price, the alleged misrepresentations or omissions must have been immaterial).

C. Materiality Determinations Depend On Information Outside The Ordinary Scope Of Class Certification Discovery

As discussed above, merits discovery usually is incomplete at the class certification stage. *See* Point A, *supra*. Therefore, if Petitioners' position is adopted and materiality becomes a question that must be addressed and decided at the class certification stage, courts will be required to decide this issue before all of the discovery needed for an informed decision on this question has been conducted.

Examining the types of evidence that may be relevant to materiality determinations shows how dramatically Petitioners' proposed rule would broaden and transform the class certification decision. As discussed above, *see* Point B, *supra*, the materiality of a particular statement or omission may depend upon management's subjective state of mind when they made that statement or omission. For example, in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991), this Court found that testimony from directors as to their motivations for supporting a proposal were relevant to the materiality analysis, and would have formed a proper basis for the jury to find that the defendants' disclosures did not neutralize the materiality of prior misstatements regarding the proposal. *See id.* at 1098. In such cases, materiality determinations will revolve around the factual question of what corporate officers knew and when they knew it. This is a classic "merits" question, and is totally unsuitable for resolution at the class certification stage. It is impossible to effectively liti-

gate such an issue without wide-ranging discovery, and it is impossible for courts to decide such an issue without conducting mini-trials of the merits of the case.

To give another example, in *Freudenberg v. E*Trade Corp*, No. 07-cv-8538, 2010 WL 1904315 (S.D.N.Y. May 11, 2010), plaintiffs alleged that defendants had made material misrepresentations about their "strict discipline" in respect to risk mitigation. *Id.* at *11-12. At the motion to dismiss stage, the court held that "[b]ecause the statements Plaintiffs allege were misleading related to the fundamental nature of E*TRADE's most important business sector and are belied by detailed allegations directly contradicting the assertions of 'discipline' . . . these statements are actionable and material." *Id.* at *12. This is a relatively straightforward issue to resolve on the pleadings, but to *prove* it would require a court to conduct a mini-trial on, *inter alia*, the inner workings of defendants' business, whether defendants were undisciplined, and the importance of the sector in question to the defendants' overall business.

Indeed, the type of causation evidence that Petitioners seek to introduce in this case is exactly the type of evidence that this Court has recently held need *not* be considered at the time of class certification. While Petitioners cloak their argument in the language of materiality, the crux of their case against class certification is actually a loss causation argument fundamentally analogous to that raised by the defendants and rejected in *Erica P. John Fund v. Halliburton*, 131 S. Ct. 2179. In *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, No. 02-cv-1152,

2008 WL 4791492 (N.D. Tex. Nov. 4, 2008), *aff'd*, 597 F.3d 330, 335-36 (5th Cir. 2010), *rev'd sub nom. Erica P. John Fund v. Halliburton Co.*, 131 S. Ct. 2179, 2185-86 (2011), the district court, operating under the mistaken belief that plaintiffs could not make use of the fraud-on-the-market theory without first establishing loss causation, held that the plaintiffs were required to show "that it is more probable than not that it was [the alleged] corrective disclosure, and not any other unrelated negative statement, that caused the stock price decline." *Id.* at *3-4. The district court then carefully examined the information that was known to the market at the time of the alleged corrective disclosures, including press releases, SEC filings, and analyst reports, to determine what actually caused the price decline. *See id.* at *4-20. It concluded that the price decline was not caused by the correction of any fraudulent misstatements, and accordingly refused to certify the class. *See id.* at *20. On appeal, the Fifth Circuit affirmed, finding that "[t]he district court explicitly recognized the need for Plaintiff to establish a causal link between the alleged falsehoods and its losses in order to invoke the fraud-on-the market presumption" and that "[w]e must bear in mind that the main concern when addressing the fraud-on-the-market presumption of reliance is whether allegedly false statements actually inflated the company's stock price." *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330, 335-36 (2010). However, this Court reversed, holding that at class certification a plaintiff is *not* required to establish loss causation to trigger the fraud-on-the-market presumption. *Erica P. John Fund. v. Halliburton*, 131 S. Ct. at 2185-86 (reject-

ing defendants' position as "not justified by *Basic* or its logic." *Id.* at 2185.

Petitioners' position here is substantially similar to the position that this Court rejected in *Halliburton*. In the courts below, Petitioners argued that their alleged omissions regarding safety concerns were immaterial because the market was already aware of those safety issues during the class period. *See Connecticut Ret. Plans & Trust Funds v. Amgen, Inc.*, No. 07-cv-2536, 2009 WL 2633743, at *12 (C.D. Cal. Aug. 12, 2009). As in *Halliburton*, Petitioners sought to bring to the court's attention analyst reports purportedly showing that the marketplace was already aware of the matters that Respondents alleged to have been concealed. *Compare Connecticut Ret. Plans*, 2009 WL 2633743, at *12 ("As evidence of the market's awareness, Defendants point to a sample of analyst reports issued on May 5, 2004, in which the analysts discuss the ODAC Meeting") *with Archdiocese of Milwaukee*, 2008 WL 4791492, at *20 (holding that plaintiffs had not established loss causation with respect to a disclosure, because the announcement "[did] not appear to have been a surprise or concern to analysts as some charge was expected") As such, Petitioners assert that any decline in stock price could not have been caused by corrective disclosures remedying the alleged omissions, since "[i]f the market has become aware of the allegedly concealed information, the facts allegedly omitted by the defendant would already be reflected in the stock's price and the market [would] not be misled." *Connecticut Ret. Plans*, 2009 WL 2633743, at *12 (internal quotations omitted). Essentially, Petitioners seek to advance an intensely fact-

based, truth-on-the-market defense at the class certification stage. *See id.* Whether this is cast as a matter of "materiality" or "loss causation," the substance is the same—Petitioners want to use the class certification hearing as a vehicle for determining whether a factor other than their alleged misrepresentations was responsible for the drop in stock price. Since this determination "has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory," Petitioners' request should be denied. *Erica P. John Fund* v. *Halliburton*, 131 S. Ct. at 2186. *See also Schleicher*, 618 F.3d at 686-87 (requiring proof of why stock price declined as a prerequisite for certification "would make certification impossible in many securities suits, because when true and false statements are made together it is often impossible to disentangle the effects with any confidence.").

To gratuitously combine the merits and procedural aspects of the Rule 23 class action as Petitioners advocate would not only transform the certification hearing, it would also have a significant effect on the incentives of institutional investors such as *amici*. Requiring lead plaintiffs to prove the validity of their claims at the class certification stage, and then again at summary judgment and trial, would inevitably increase the costs and delays of class litigation in comparison to individual litigation, leading some potential lead plaintiffs to forego class treatment of their claims and file solo actions. This would be efficient for the individual litigants (since they would bypass the certification stage entirely and proceed directly to proving their claims), but not for the

judicial system generally or even for defendants. Moreover, implicitly discouraging institutional investors from serving as class representatives by needlessly raising the barriers to class certification is directly contrary to the intent of the PSLRA. *See Tellabs*, 551 U.S. at 320-21.

In short, requiring a contextual, fact-intensive matter such as materiality to be litigated and decided at the class certification stage is not consistent with the class certification hearing's proper focus and purpose. The rule that Petitioners advocate would prejudice plaintiffs by forcing decision on the materiality issue prior to completion of the discovery needed properly to evaluate the issue.

CONCLUSION

For the reasons stated herein and in the Respondent's Brief, the Court of Appeals' decision upholding the District Court's grant of class certification should be affirmed.

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AMICUS CURIAE BRIEF

RECORD AND BRIEFS

No. 11-1085

IN THE

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Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICI CURIAE* CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, PHARMACEUTICAL RESEARCH AND MANUFACTURERS OF AMERICA, AND BIOTECHNOLOGY INDUSTRY ORGANIZATION SUPPORTING PETITIONERS

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QUESTIONS PRESENTED

1. Whether, in a misrepresentation case under SEC Rule 10b-5, the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory.

2. Whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

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INTEREST OF *AMICI CURIAE*[1]

The *amici curiae* are the Chamber of Commerce of the United States of America (the "Chamber"), the Pharmaceutical Research and Manufacturers of America ("PhRMA"), and the Biotechnology Industry Organization ("BIO"). Each has a significant interest in the inter-

[1] No counsel for a party authored this brief in whole or in part. No person or entity other than *amici*, their members, or their counsel made a monetary contribution intended to fund the preparation or submission of this brief. Petitioners and respondent have filed blanket consent letters with the Clerk.

pretation and enforcement of the federal securities laws and the rules governing class actions in private securities cases.

The Chamber is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. The Chamber's members transact business throughout the United States and a large number of countries around the world. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. The Chamber has participated as *amicus curiae* in various class-action appeals, including recently in this Court.

PhRMA is a voluntary, nonprofit association that represents the country's leading research-based pharmaceutical and biotechnology companies. PhRMA's members invent and develop medicines that save lives and improve the quality of life for millions of patients around the world. PhRMA's members have invested hundreds of billions of dollars in the last decade to develop new medicines—including over $45 billion in 2010 alone. PhRMA serves as the industry's principal policy advocate, advancing policies that foster continued medical innovation, and has participated as *amicus curiae* in appeals involving issues of significance to the pharmaceutical industry. The issues in this case are especially significant to PhRMA members because many of them have borne the expense and burden of defending against securities-fraud class actions in recent years, which raise the already substantial cost and risks of developing new medicines.

BIO is the world's largest biotechnology organization, representing more than 1,100 members in all 50 states. BIO's members are involved in the most cutting-edge research and development of breakthrough technologies that are helping to heal, fuel, and feed the world. They range from entrepreneurial start-ups developing a first product to Fortune 100 multinationals. These members, the vast majority of which are small companies that have not yet brought a product to market or attained profitability, currently have more than 370 products in clinical trials aimed at curing or treating more than 200 diseases. BIO's industrial biotech members are developing renewable and cleaner sources of energy and alternative industrial processes, and its agriculture members are helping to improve farm yields, incomes, and nutritional outcomes, while reducing environmental damage. BIO also represents academic research centers, state and regional biotechnology associations, and service providers to the industry, including venture capital firms that fund large segments of the industry. The biotechnology industry as a whole invests more than $20 billion annually on research and development activities, and supports the employment of more than 8 million people in the United States alone. BIO's mission is to promote a policy, business, and legal environment in which this massive capital and human investment can achieve fully the promise of biotechnology to heal, fuel, and feed the world.

Given this mission, BIO closely monitors legal issues that affect the industry and often offers its perspectives in cases raising such issues in state and federal courts, including this Court. The issues in this case are especially significant because the court of appeals' unjustified expansion of class actions threatens to strangle the ability of BIO members to innovate by entangling them in

massive lawsuits that never should have been certified in the first place.

SUMMARY OF ARGUMENT

By departing from this Court's decisions, the court of appeals has inadvertently encouraged frivolous lawsuits that produce no discernible benefit in deterring actual, fraudulent behavior. Indeed, this Court has observed that improper class certification perversely pressures defendants to settle even meritless lawsuits. The enormous costs that class actions inflict on economic productivity and innovation counsel in favor of strictly applying Rule 23 in securities cases. Just as our substantive securities laws were not intended to provide investors insurance against market losses, courts must guard against lenient class-certification standards that would have the same forbidden effect.

As petitioners have explained, the decision below conflicts with this Court's opinions in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), and *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179 (2011), by relieving plaintiff of its burden to show materiality and preventing defendants from rebutting the presumption of reliance at class certification. Under those cases, the "fundamental premise" of the rebuttable presumption of classwide reliance is the impact a misrepresentation has on the market price. Thus, *Basic* holds that a plaintiff seeking class certification under the presumption of reliance must prove that the alleged misrepresentations were material, and a defendant may produce rebuttal evidence that the misstatements were not material. For if an alleged misrepresentation is not material, it will not move the market price of a stock that trades in an efficient market. If the market price is not distorted, there is no basis for presuming that the entire class relied on misrepresentations by relying on the market price. Individual class mem-

bers will need to prove actual reliance on the misrepresentation, rendering class certification impossible.

The decision below also contradicts last Term's decision in *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541 (2011). *Wal-Mart* established beyond doubt that a plaintiff must prove that the Rule 23 requirements are "in fact" satisfied. In this case, as in most Rule 10b-5 cases, the lead plaintiff cannot satisfy Rule 23(b)(3)'s predominance requirement unless it can trigger and sustain the presumption of classwide reliance. The court of appeals failed to put the plaintiff to its proof. It relieved the plaintiff of the duty to prove the materiality prerequisite to the presumption of reliance. And it prevented the defendants from introducing relevant evidence to rebut the presumption. Thus, the court of appeals improperly allowed class certification without determining whether the plaintiff can "in fact" satisfy Rule 23(b)(3).

In so doing, the court of appeals ignored the nature of the rebuttable presumption created by *Basic*. The *Basic* Court cited Federal Rule of Evidence 301 in creating the presumption of reliance. A rebuttable presumption under that Rule requires the plaintiff to prove the *prima facie* case to invoke the presumption—including materiality—by a preponderance of the evidence. And such a presumption may be rebutted whenever the plaintiff invokes it, including at class certification. Finally, a rebuttable presumption does not shift the ultimate burden of persuasion away from the plaintiff. If, as here, a defendant produces some evidence that severs the link between the misrepresentation and the market price, the plaintiff must carry the ultimate burden of proving its entitlement to the presumption of reliance by the preponderance of evidence. Thus, both *Wal-Mart* and the origins of the presumption in Rule 301 dictate that the plaintiff is responsible for proving materiality in order to

obtain class certification under the fraud-on-the-market presumption.

District courts—including those with the most experience in securities cases—routinely resolve disputes over materiality and related issues at the class-certification stage. Courts regularly address whether a misrepresentation is material by considering expert analysis of public statements and event studies that assess whether the alleged misrepresentations affected the market price. These courts have not encountered any difficulty in putting plaintiffs to the proof required of them under Rule 23 and the presumption of reliance. They certify classes where statements were material and distorted the market price. And they deny certification when they cannot make such findings. Federal district courts should continue the Rule 23-mandated work they are already doing.

ARGUMENT

I. The Court Of Appeals' Decision Is Contrary To Both *Basic* And *Erica P. John Fund*

1. As this Court recognized in *Basic Inc.* v. *Levinson*, 485 U.S. 224, 242 (1988), "[r]equiring proof of individualized reliance * * * effectively * * * prevented [securities-fraud plaintiffs] from proceeding with a class action, since individual issues * * * overwhelmed the common ones." To remedy that perceived problem, the Court in *Basic* ruled that a putative class-action plaintiff may obtain a rebuttable presumption of classwide reliance by using the "fraud-on-the-market" theory. 485 U.S. at 245. The fraud-on-the-market theory assumes that in an efficient, well-developed market, all public, material information about a company is known to the market and reflected in the company's stock price. *Id.* at 246. The theory further posits that "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of [the market] price." *Id.* at 247. Because material

misrepresentations presumably distort the market price, "an investor's reliance on any public, material misrepresentations * * * may be presumed for purposes of a Rule 10b-5 action." *Ibid.*[2]

To trigger the fraud-on-the-market presumption of reliance, the plaintiff must "plead and prove" certain "threshold facts": that (1) the defendant "made public, material misrepresentations"; (2) the defendant's shares were traded in an "efficient market"; and (3) "the plaintiff traded shares between the time the misrepresentations were made and the time the truth was revealed." *Basic*, 485 U.S. at 248 & n.27.

Even if the plaintiff successfully proves these threshold facts, the presumption of reliance remains "subject to rebuttal." *Basic*, 485 U.S. at 245. Thus, where the record shows that "the market price [was] not * * * affected by [the] misrepresentations," the presumption is rebutted—the plaintiff class *cannot* have relied on misrepresentations by relying on a distorted market price where the market price was not affected. *Ibid.*

2. Under the court of appeals' holding, the fraud-on-the-market presumption provides a free pass to class certification for any plaintiff suing a company whose stock trades in a generally efficient market. *Amici* agree with petitioners' persuasive demonstration that the court of appeals departed from this Court's presumption-of-

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[2] As discussed *infra*, at 28, the theories underpinning *Basic*'s presumption of reliance have come under increasing scholarly attack. Yet even accepting the continuing validity of *Basic*, the court of appeals improperly upheld certification of a class that could not show classwide reliance through *Basic*'s presumption. At the least, *Basic*'s questionable economic reasoning counsels against further weakening the requirements of *Basic* and Rule 23 for obtaining class certification under the fraud-on-the-market presumption of reliance.

reliance doctrine by relieving plaintiffs of the burden of showing materiality.

Moreover, petitioners here introduced rebuttal evidence that the alleged misrepresentations were immaterial because the truth was already known to the market. In refusing to consider that evidence, the court of appeals not only violated the principles of *Basic* set forth above; it also ignored *Basic*'s specific endorsement of that precise type of rebuttal evidence.

As this Court held in *Basic* and reaffirmed just last Term, the "materiality requirement is satisfied when there is a substantial likelihood that the disclosure * * * would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Matrixx Initiatives, Inc.* v. *Siracusano* 131 S. Ct. 1309, 1318 (2011) (quoting *Basic*, 485 U.S. at 231-232). A statement that does not alter the total mix of information available will not affect the company's stock price in an efficient market. As then-Judge Alito wrote for the Third Circuit, "[i]n the context of an 'efficient' market, the concept of materiality translates into information that alters the price of the firm's stock." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997). Accord *Oran* v. *Stafford*, 226 F.3d 275, 282 (3d Cir. 2000) (Alito, J.) ("if a company's disclosure of information has no effect on stock prices, it follows that the information disclosed * * * was immaterial as a matter of law") (quotation omitted).

This Court recognized as much in *Basic*, positing this hypothetical in which the presumption of reliance would be rebutted:

> if petitioners could show that the "market makers" were privy to the truth about the merger discussions here with Combustion, and thus that the market price would not have been affected by their mis-

> representations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone.

Basic, 485 U.S. at 248.

That hypothetical tracks the facts here. A statement that does not alter the reasonable investor's valuation of the stock is immaterial and cannot distort the market price in an efficient market. Therefore, it makes no sense to presume that the entire class of investors relied on the misrepresentations by relying on the market price.

3. The Court's decision last Term in *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179, 2187 (2011), held that a plaintiff need not prove "loss causation" in order to trigger the presumption of reliance and declined to "address any other question about *Basic*, its presumption, or how and when it may be rebutted."

While *Erica P. John Fund* did not answer the question presented here, its powerful reaffirmation of *Basic*'s price-centered rationale strongly suggests that the court of appeals was wrong to certify a class based on immaterial statements. The Court declared that "*Basic*'s fundamental premise" is "that an investor presumptively relies on a misrepresentation *so long as it was reflected in the market price* at the time of his transaction." (emphasis added). *Erica P. John Fund*, 131 S. Ct. at 2186. Indeed, the Court directly contrasted *Basic*'s requirement that "a misrepresentation * * * affected the integrity of the market price" with its rejection of the Fifth Circuit's requirement that the misrepresentation "also caused a subsequent economic loss." *Ibid.*

The opinion in *Erica P. John Fund* also reaffirmed that "the presumption was just that, and could be rebutted by appropriate evidence." 131 S. Ct. at 2185 (citing *Basic*, 485 U.S. at 248). And it cited *Basic*'s recognition that absent a plaintiff's ability to sustain the presumption

of reliance, a class cannot be certified because individualized issues of reliance will predominate. *Ibid.*

In refusing to consider whether the alleged misrepresentations were material, the court of appeals certified a class where *Basic*'s "fundamental premise" of price distortion was missing. Likewise, in refusing to consider rebuttal evidence, the court ignored *Erica P. John Fund*'s reminder that *Basic* created a *rebuttable* presumption, without which classes may not be certified. A rebuttable presumption created to aid class certification must necessarily be rebuttable at the class-certification stage. Otherwise, the presumption would be effectively irrebuttable and classes would be routinely certified in error. Cf. *John R. Sand & Gravel Co.* v. *United States*, 552 U.S. 130, 137 (2008) ("the word 'rebuttable' means that the presumption is not conclusive"). That is because a defendant's rebuttal of the presumption "defeats certification by defeating the Rule 23(b)(3) predominance requirement." *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 485 (2d Cir. 2008).

II. The Court Of Appeals' Decision Conflicts With *Wal-Mart*.

1. *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541 (2011) establishes two fundamental principles. First, to certify a class, a plaintiff "must affirmatively demonstrate [its] compliance" with Rule 23; it must "prove" that it "*in fact*" satisfies all of the Rule's requirements. *Wal-Mart*, 131 S. Ct. at 2551. Second, in determining whether the plaintiff has carried its burden to satisfy Rule 23, the court must often consider issues that "overlap with the merits of the plaintiff's underlying claim." *Id.* at 2551-2552. The district court must resolve all disputes related to class certification even if such a dispute will have to be resolved again on the merits. *Id.* at 2552 n.6.

2. As petitioners have extensively shown, the court of appeals ignored *Wal-Mart*'s logic. *Wal-Mart* makes crystal clear that fraud-on-the-market plaintiffs may not cry "merits" or "classwide issue" as a means of escaping their burden to prove that common issues "in fact" predominate. The Court plainly recognized that market efficiency is both a merits issue and an issue that stands or falls on a classwide basis, yet a plaintiff must prove market efficiency if it is to "establish the applicability" of the presumption of reliance, and by extension, predominance of common issues. *Wal-Mart*, 131 S. Ct. at 2552 n.6. There was no principled basis for the court of appeals to require proof of market efficiency, but not the equally important presumption-of-reliance element of materiality.

The necessity of proving classwide, merits-related facts inheres in a plaintiff's choice to proceed under the presumption of reliance. A plaintiff could of course avoid making these merits-related showings by proving that *actual* reliance is a common issue. But a plaintiff opting to use the presumption of reliance must necessarily make a number of classwide, merits-related showings to establish that a classwide presumption makes sense: the statements must be public, material, and received by a generally efficient market. These are all common issues that plaintiffs will have to prove again at trial in order to establish the merits element of reliance. Materiality, like market efficiency, presents precisely the "overlap" between merits and Rule 23 issues that *Wal-Mart* requires district courts to embrace. Just as a plaintiff who chooses to prove *actual* reliance may not escape Rule 23's stringent requirements, a plaintiff who elects to proceed under the judicially created presumption cannot relieve himself of Rule 23's burdens merely because the option

he chose requires proof that pertains to both class certification and the merits.

Of course, at the class-certification stage, the district court is not considering materiality issues for the sake of determining the substantive merits of plaintiffs' claims, but only to determine whether they may proceed as a class. Proof of materiality for purposes of proving the substantive merits of a 10b-5 claim is properly preserved for summary judgment or trial. And a judge's rulings on materiality for certification purposes do not bind the judge or jury if they later address materiality for merits purposes. *In re Initial Public Offerings Sec. Litig.*, 471 F.3d 24, 41 (2d Cir. 2006) ("[T]he determination as to a Rule 23 requirement is made only for purposes of class certification and is not binding on the trier of facts, even if that trier is the class certification judge."); see also *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 318 n.19 (3d Cir. 2008); accord *Blades* v. *Monsanto Co.*, 400 F.3d 562, 566-567 (8th Cir. 2005). The court of appeals erroneously believed that materiality is a pure "merits" issue that may not be decided at the class certification stage. It is not. It is merely a prerequisite to invoking the presumption of reliance, and it is to be addressed at the class-certification stage solely for the purpose of determining whether classwide reliance may be presumed.

3. The court of appeals mistakenly disallowed materiality evidence because the absence of materiality would cause the claims of *all* class members to fail on the merits. Thus, in its view, the materiality determination is a common question that does not preclude class certification. This misconceives the Rule 23 inquiry. Materiality is directly relevant, under *Basic*, to whether the plaintiffs can avail themselves of the presumption of classwide reliance. If they cannot, individual questions of reliance predominate and the class may not be certified. The fact

that the materiality inquiry may also result in a common answer on the separate materiality element does not somehow vitiate its relevance to whether individual issues of reliance predominate—issues that would overwhelm any common issues in the case. It would be frankly absurd to certify a class because individual reliance issues predominate for a reason that reveals a common failing on another element. Predominance of individualized reliance issues prevents certification in securities fraud cases. *Basic*, 485 U.S. at 242. That firm legal threshold may not be circumvented merely because assessing the applicability of the presumption of reliance necessarily implicates certain classwide issues.

Whether there was a material misstatement upon which presumptive reliance can be premised is the very question that determines whether there is a classwide reliance issue that unites class members or whether there are instead individualized reliance issues that separate them. Purchasers of Amgen stock decided to buy for any number of reasons. "Without some glue holding the alleged *reasons* for all those decisions together," a securities-fraud class cannot be certified. *Wal-Mart*, 131 S. Ct. at 2552. The presumption of reliance is the only "glue" identified by respondent; if that fails, even for a reason common to the class, predominance is lacking and class certification is improper. *Id.* at 2552-2553 (denying certification in absence of corporate-level sex-discrimination policy).[3]

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[3] As mentioned above, the court of appeals' rationale would preclude consideration of market efficiency at the class-certification stage, for that is also a common question that, if answered negatively, would doom plaintiffs' claims on the merits. At least one court has followed the court of appeals' reasoning to its logical conclusion. See, *e.g.*, *Simpson* v. *Specialty Retail Concepts*, 149 F.R.D. 94, 100-101 (M.D.N.C. 1993) ("While the better practice for plaintiffs wishing to

III. The Nature Of Rebuttable Presumptions Teaches That Plaintiffs Must Prove—and Defendants Must Be Allowed To Rebut—Materiality At The Class-Certification Stage.

1. Nothing in *Basic* suggested that the presumption of reliance should be transformed—during any stage of litigation—into a mandatorily accepted fact. Quite the contrary, *Basic* explained that the presumption is a mere procedural tool. Though the Court cited "[r]ecent empirical studies" tending to confirm the fraud-on-the-market theory, 485 U.S. at 246, it did not task itself with "assess[ing] the general validity" of that theory. *Id.* at 242. Instead, the Court relied on Federal Rule of Evidence 301 for adopting a procedural "device for allocating the burdens of proof between parties." *Id.* at 245.

To implement the fraud-on-the-market presumption, the courts below needed to look no further than this Court's holdings applying Rule 301. Under Rule 301, "the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption," but a presumption "does not shift the burden of persuasion, which remains on the party who had it originally." Fed. R. Evid. 301.[4]

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avail themselves of the fraud on the market theory would be to allege facts showing that the instant market is indeed efficient, the Court is of the opinion that a full scale investigation into the efficiency of the market at the class certification stage delves too much into the merits of the case."). But after *Wal-Mart* and *Erica P. John Fund* reaffirmed the market-efficiency prerequisite for class certification, that line of reasoning is foreclosed.

[4] Though Rule 301 was restyled in 2011, "[t]he Committee made special efforts to reject any purported style improvement that might result in a substantive change in the application of a rule." Fed. R. Evid. 301 advisory comm. note, 2011 Amendment.

This Court has explained each of the procedural steps governing the order of proof where a Rule 301 presumption applies. See *St. Mary's Honor Ctr.* v. *Hicks*, 509 U.S. 502, 511 (1993). First, to invoke the presumption, either a plaintiff's evidence must establish the *prima facie* case by a preponderance of the evidence, or a judge must determine that any rational person would have to find the existence of facts constituting the *prima facie* case. *Id.* at 509-510 & n.3. Second, once created, the "presumption places upon the defendant the * * * burden of producing" evidence that, if believed by the trier of fact, would support a finding that the presumed fact does not exist. *Id.* at 506-507. Third, if "the defendant has succeeded in carrying its burden of production," the presumption "is no longer relevant," and the plaintiff must persuade the trier of fact of the ultimate fact by a preponderance of the evidence. *Id.* at 510-511.

2. Applying those principles here, *whenever* a plaintiff wishes to invoke the benefits of the presumption—whether to gain class certification or to prevail on the merits—it must prove each of the "threshold facts" identified by *Basic* by a preponderance of the evidence. This includes materiality. A plaintiff cannot avoid the need to prove materiality or any other part of his *prima facie* case for invoking the presumption, merely because it first arises at the class-certification stage. That would allow the plaintiff to enjoy the benefit of the presumption for class certification without proving the very facts that give rise to the presumption.

3. Apart from the plaintiff's initial burden to prove materiality at the class-certification stage, the defendant may produce rebuttal evidence on materiality to defeat the presumption of reliance and, by extension, class certification. Merely completing the *prima facie* stage of the rebuttable presumption does not mean plaintiffs have

"prove[n]" that they "*in fact*" satisfy Rule 23(b)(3)'s predominance requirement. *Wal-Mart*, 131 S. Ct. at 2551. Indeed, the predominance inquiry "*cannot be made* without determining whether defendants can successfully rebut the fraud-on-the-market presumption." *Salomon*, 544 F.3d at 485 (emphasis added). Consequently, the defendant's rebuttal must be considered "prior to class certification." *Id.* at 484.

The defendant retains the right to rebut the presumption whenever it is invoked—at class certification or otherwise. That much is clear from *Basic* itself, its background history, and common sense. *Basic* involved an appeal, *inter alia*, of a class-certification order. Against that backdrop, the Court created a presumption that makes class certification possible in securities cases. But it made that presumption rebuttable. Nothing in *Basic*—and nothing before or since—suggests that this rebuttable presumption may not be rebutted when it is invoked at the class certification stage—the very stage for which it was created. *Basic* created a "nonconclusive" presumption, *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 341-342 (2005), and there is no indication that this Court intended this powerful, class-enabling tool to be conclusive at the most critical stage of a securities suit. Nor has anyone identified any other rebuttable presumption that may not be rebutted at the procedural stage in which it is invoked.

The case law on which *Basic* relied in creating its presumption of reliance demonstrates that the Court did not intend to create a rebuttable presumption for use in obtaining class certification, yet—with no explanation—render that presumption *irrebuttable* at the class-certification stage. *Basic* favorably cited the presumption of reliance in *Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. 128, 153-154 (1972), which arises

when an issuer makes material omissions despite a duty to disclose. See *Basic*, 485 U.S. at 243, 245. Courts had always understood that the *Affiliated Ute* presumption was rebuttable at the class-certification stage.

Less than a month before *Basic* was handed down, for instance, the Eleventh Circuit spent considerable energy deciding whether "[t]he presumption, derived from *Ute*" had been rebutted by the defendant. *Ross* v. *Bank South, N.A.*, 837 F.2d 980, 993 (11th Cir. 1988). That discussion, *id.* at 993-998, took place in Part II, "Class Certification"—*not* in Part III, "Merits," where the respondent's theory would place it.[5] While the court concluded that defendants had not successfully rebutted the presumption, *id.* at 997, it went out of its way to emphasize that it did "not, of course, intend to preclude a district court from exercising its discretion in a proper case to *deny certification*" in cases where rebuttal was successful. *Id.* at 996 n.11 (emphasis added).

A similar approach appears in *Blackie* v. *Barrack*, 524 F.2d 891 (9th Cir. 1975), a seminal presumption case later cited by *Basic*, see 485 U.S. at 244-245, 247 n.25. *Blackie* arose in the context of a conditional certification, 524 F.2d at 894, and explained that the presumption simply "shift[s] to defendant the burden of disproving a prima facie case of causation." *Id.* at 906. This rebuttal discussion was in the certification, and not the trial, context—the part, section, and sub-section in which it occurs were respectively entitled: (1) "[c]ompliance with the [r]equirements of Fed. R. Civ. P. 23(a) and (b)(3)," (2)

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[5] The Eleventh Circuit subsequently took the case *en banc*, where (as to some issues) it departed from the panel, finding no securities-fraud violation. See *Ross* v. *Bank South, N.A.*, 885 F.2d 723, 732 (11th Cir. 1989) (*en banc*). The panel opinion thus is cited here merely as an illustration of when the presumption could be rebutted (a conclusion unchallenged by the *en banc* court).

"[t]he merits of class certification," and (3) "[p]redominance and reliance." *Id.* at 900, 901, 905.

The late Judge Charles Clark, writing in the much-cited (and hardly anti-class) *Shores* v. *Sklar*, observed that "*[w]hen* the *Ute* presumption attaches, the defendant may rebut it by showing that the plaintiff did not rely on the defendant's duty to disclose." 647 F.2d 462, 468 (5th Cir. 1981) (*en banc*) (emphasis added). Though *Shores* did not involve a certification challenge, this common-sense proposition—that *when* the presumption is invoked, *then* the defendant may rebut—is the common-sense principle that respondent asks the Court now to reject.

4. *Basic* recognizes that a defendant may rebut the presumption by rebutting the elements of the presumption—such as materiality—or by making "*[a]ny showing* that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff." *Basic*, 485 U.S. at 248 (emphasis added). A showing that the alleged misrepresentation was immaterial or did not impact the market price necessarily rebuts the presumption of reliance. *Ibid.* In the absence of price distortion, "the basis for finding that the fraud had been transmitted through market price would be gone." *Ibid.* And if the misrepresentation was immaterial or did not distort the market price, there is no basis for presuming that the class indirectly relied on the misrepresentation by relying on the market price. Materiality and price-impact rebuttal are thus closely related. As the Second Circuit put it:

> If plaintiffs can show that the alleged misrepresentation was material and publicly transmitted into a well-developed market, then reliance will be presumed, for if a reasonable investor would think that the information would have 'significantly altered

> the total mix of information,' then it may be presumed that, in an efficient market, investors would have taken the omitted information into account, thereby affecting market price.

Salomon, 544 F.3d at 483. By the same token, if the alleged misrepresentation is immaterial, it would not distort the stock price in an efficient market.

Amgen's evidence pertaining to materiality falls within this broad right of rebuttal. It both rebuts the materiality element of the presumption and constitutes a showing that severs the link between the misrepresentation and the price paid by the plaintiff. As discussed above, there is no basis for distinguishing a materiality rebuttal from any other sort of rebuttal of the presumption of reliance —such as market efficiency—that is concededly available at the class-certification stage.

The quantum of rebuttal evidence required of a defendant is light, consistent with *Basic*'s "any showing" formulation and its citation of Rule 301. Contrary to respondent's intimations, Amgen does not bear the burden of conclusively proving that the misrepresentations were immaterial or had no impact on the stock price. A rebuttable presumption does not shift the burden of proof away from the plaintiff. Rather, at the rebuttal stage, Amgen need only produce evidence that could support a factfinder's belief that the statements were immaterial or did not move the stock price. Amgen's evidence that the truth was on the market before its alleged misrepresentations amply satisfies this burden.

5. If the defendant satisfies this burden of production, the presumption is "no longer relevant." *Hicks*, 509 U.S. at 510. The plaintiff would then be required to prove by a preponderance of evidence that the alleged fraud had been transmitted through the market price. *Salomon*, 544 F.3d at 486 ("If defendants attempt to make a rebut-

tal, * * * the district judge must receive enough evidence * * * to be satisfied that each Rule 23 requirement has been met."). If the plaintiff could not prove classwide reliance via reliance on a distorted market price, individualized issues of reliance would predominate and the class could not be certified. *Id.* at 485 (holding that a "successful rebuttal defeats certification by defeating the Rule 23(b)(3) predominance requirement").

The rebuttable presumption of reliance therefore offers no escape hatch for plaintiffs seeking to avoid their ultimate burden to prove materiality—and the applicability of the presumption—by the preponderance of the evidence at the class-certification stage. That requirement is dictated by both *Basic*'s invocation of Rule 301 and the plaintiff's Rule 23 burden to show that common issues predominate over individual ones.

IV. District Courts Routinely Consider Materiality At The Class-Certification Stage, Denying Class Certification Where The Presumption Of Classwide Reliance Is Not Warranted.

District courts regularly resolve factual disputes over materiality and related issues, allowing cases to proceed as class actions only when they find the presumption of reliance justified. Practical experience teaches that there is no reason to fear allowing district judges to do precisely what Rule 23 requires of them.

Judges often consider event studies, expert testimony, and analyst reports in determining whether an alleged misrepresentation was material and had an impact on market price. As petitioners have persuasively explained, this individualized analysis of each alleged misrepresentation is much more consistent with the fraud-on-the-market theory of reliance than an inquiry into whether the market for a given stock is efficient as a general matter. Pet. Br. 30-34. Yet even the lower

courts that consider only generalized market efficiency at the class-certification stage receive evidence and resolve disputes in a way that demonstrates courts' ability to address materiality and price-impact issues at the same stage.

1. Since the Second Circuit's holding in *Salomon*, district judges within the Southern District of New York have, with no apparent problems, enforced *Basic*'s materiality requirement and allowed defendants to rebut with respect to materiality and price impact at the class-certification stage.

For example, in *Berks County Employees' Retirement Fund* v. *First American Corp.*, 734 F. Supp. 2d 533 (S.D.N.Y. 2010), the court denied class certification because plaintiff "has not demonstrated that defendants' alleged misstatements and omissions were material. It therefore cannot avail itself of a presumption of reliance under * * * the fraud-on-the-market doctrine." *Id.* at 541. In reaching that conclusion, the court critically analyzed "the event study of [plaintiff's] expert witness." *Id.* at 538. It determined that plaintiff failed to show the alleged misrepresentation "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at 539. And it held that the event study's finding of stock-price declines could not show materiality because the alleged information causing the declines was no different than facts "that had been disclosed publicly" several days (or weeks) earlier. *Id.* at 540-541. After finding plaintiff's expert "unconvincing" and "reject[ing] his study as a basis for a finding of materiality," the court, in the alternative, "credit[ed] the opinion of defendants' expert witness" that demonstrated that none of the alleged misrepresentations had an impact on stock price. *Id.* at 541 & n.52.

Similarly, in *In re Credit Suisse First Boston Corp. (Lantronix, Inc.) Analyst Sec. Litig.*, 250 F.R.D. 137 (S.D.N.Y. 2008), the plaintiff alleged that as part of an illicit agreement between Credit Suisse and Lantronix, a Credit Suisse analyst issued false favorable reports on Lantronix. Credit Suisse offered evidence that the alleged corrective disclosure that supposedly caused the stock-price decline had previously entered the marketplace with no effect on the stock price. *Id.* at 147-149. In the face of this evidence, the court held that the plaintiff did not meet its burden to prove by a preponderance of the evidence that the disclosure of the misleading nature of the analyst reports resulted in the price decrease. *Id.* at 142-143 & n.11. "With the benefit of ample evidence * * * that demonstrates the absence of market impact, the Court finds that the *Basic* presumption is not properly applicable here and thus that Plaintiff has not carried his burden of demonstrating that the elements of Rule 23(b) have been satisfied." *Id.* at 143. "In the alternative," the court reasoned, "if Plaintiff's showing is sufficient to establish the presumption, Defendants have rebutted it here." *Id.* at 143 n.11.

By contrast, district courts have certified classes where the plaintiff proved materiality and the preponderance of the evidence showed that the alleged misrepresentations distorted the market price. Thus, in *In re Sadia, S.A. Sec. Litig.*, 269 F.R.D. 298 (S.D.N.Y. 2010), the district court certified the class after extensively analyzing the alleged misstatements' materiality and comparing event studies and expert reports that revealed the misrepresentations' impact on stock price. *Id.* at 310-315. And, in *In re Monster Worldwide, Inc. Sec. Litig.*, 251 F.R.D. 132 (S.D.N.Y. 2008), the court certified the class upon holding that plaintiff proved materiality with evidence that the defendant had "tacitly acknowledged"

making materially misleading statements and its independent auditor had "publicly opined" that the defendant had made "material misstatements in annual financial statements." *Id.* at 138-139. Moreover, the court found that the stock price declined by a statistically significant amount when the alleged fraud was revealed. *Ibid.*

A proper individualized assessment of each misrepresentation's materiality and price impact means that courts may certify a class with respect to some misrepresentations, but not others. That is what happened in *In re American International Group Sec. Litig.*, 265 F.R.D. 157 (S.D.N.Y. 2010), where the court reduced the size of the class after considering both plaintiff's and defendant's price-impact evidence with respect to each alleged misrepresentation. *Id.* at 181-182, 189.

Courts, moreover, have faithfully enforced *Basic*'s instruction that a plaintiff does not achieve class certification merely by making an initial showing that a given misstatement was material. The defendant may rebut by proving that the misrepresentation did not distort the market price and therefore could not support the presumption of classwide reliance. For example, in *In re Moody's Corp. Sec. Litig.*, 274 F.R.D. 480 (S.D.N.Y. 2011), the court found that "Plaintiffs have satisfied [their] burden" to show that Moody's alleged misrepresentations about its issuer-pays rating model were material. *Id.* at 490. But after carefully analyzing dueling event studies concerning the alleged misrepresentations' impact on market price, the court denied certification because the "Defendants have successfully rebutted the fraud on the market presumption." *Id.* at 492-493. Thus, plaintiffs were "unable to satisfy their burden of proving that common questions of reliance predominate." *Id.* at 494.

Amici discuss these cases not to endorse every aspect of the reasoning or outcome of any given case. Rather, these cases helpfully illustrate that district courts are perfectly capable of assessing materiality and price-impact evidence at the class-certification stage. And they show that courts have reached a range of results—granting certification, partially certifying, and denying certification—depending on the materiality and price impact of the relevant misrepresentations. Ensuring that putative securities-fraud classes in fact satisfy Rule 23 neither burdens district courts nor results in decisions that are favorable to only plaintiffs or only defendants. Indeed, it advances judicial efficiency and the due-process rights of both plaintiffs and defendants.

2. Even in courts that do not formally require proof that each misrepresentation is material and distorted the market price, district judges make evidentiary inquiries that differ little from those undertaken in courts that fully enforce *Basic*'s requirements. For instance, securities-fraud plaintiffs already use event studies and expert testimony to demonstrate market efficiency, which undisputedly must be proven to invoke the presumption. Cf. *Cammer* v. *Bloom*, 711 F. Supp. 1264, 1287 (D.N.J. 1989) (to establish market efficiency, a plaintiff must prove stock price reacted to unexpected company-specific news). And the same event studies used to show market efficiency are often likewise used to show that the alleged misrepresentations materially affected the market price. See, *e.g.*, Fisher, *Does the Efficient Market Theory Help Us Do Justice in a Time of Madness?*, 54 Emory L.J. 843, 871, 878 (2005); *In re Xcelera.com Sec. Litig.*, 430 F.3d 503, 512 & n.10, 513 (1st Cir. 2005) (affirming finding of market efficiency where plaintiffs presented an "event study" showing that stock "reacted strongly * * * to new information concerning the company (including *

* * disclosures at issue in this case"). Some courts even deny class certification after market-efficiency assessments that closely track materiality and price-impact inquiries. See, *e.g.*, *Dean* v. *China Agritech*, No. 11-CV-01331-RGK, 2012 WL 1835708, at *3, *7–*8 (C.D. Cal. May 3, 2012) (denying class certification after holding that because the calculations and analysis in plaintiffs' expert's event study were flawed, plaintiffs did not meet their burden to show a causal relationship between the disclosures and the price declines, and thus did not provide sufficient evidence of market efficiency); *In re Polymedica Corp. Sec. Litig.*, 453 F. Supp. 2d 260, 265 (D. Mass. 2006) (denying class certification where plaintiff failed to show "a cause-and-effect relationship over time between unexpected corporate events or financial releases and an immediate response in stock price"); cf. *In re Fed. Home Loan Mortg. Corp. (Freddie Mac) Sec. Litig.*, 281 F.R.D. 174, 182 (S.D.N.Y. 2012) (denying class certification after holding that, due to flaws in plaintiff's expert's event study, plaintiff provided no persuasive evidence that material news promptly affected the market price, and thus did not meet its burden to show market efficiency).

There can be no serious dispute that parties are able to contest—and district courts are equipped to adjudicate—evidentiary disputes over materiality and price impact at the class-certification stage. Thus, there is no practical reason preventing this Court from assigning district judges the tasks that *Basic* and Rule 23 mandate.

V. Reversal Is Necessary To Ensure That The Presumption Of Reliance Is Not Used To Coerce Settlements Where Class-Action Treatment Is Inappropriate.

1. The framework set forth in *Basic* imposes carefully calibrated burdens on plaintiffs and permits defendants

broad rights of rebuttal, all to ensure that class-action treatment is appropriate. The court of appeals' decision, however, misuses the *Basic* presumption as a virtual rubberstamp for class certification in Rule 10b-5 securities cases involving public companies. Such a result cannot be reconciled with the notions of "fairness, public policy, * * * probability, [and] judicial economy," on which *Basic* relied in creating its presumption of reliance. 485 U.S. at 245. To defer for merits resolution questions essential to whether the case should proceed as a class action in the first instance is wasteful in the extreme.

2. The *in terrorem* effects of a class-certification order also counsel against lightening the Rule 23 burden for securities-fraud plaintiffs. Class certification is usually the entire ballgame for defendants. "A court's decision to certify a class * * * places pressure on the defendant to settle even unmeritorious claims." *Shady Grove Orthopedic Assocs., P.A.* v. *Allstate Ins. Co.*, 130 S. Ct. 1431, 1465 n.3 (2010) (Ginsburg, J., dissenting). Judge Friendly aptly described such settlements as "blackmail." Friendly, *Federal Jurisdiction: A General View* 120 (1973). Certifying fraud-on-the-market classes without requiring plaintiffs to prove materiality or affording defendants the opportunity to rebut will inevitably lead to the settlement of countless weak cases—indeed, cases that are not only meritless, but which never should have been certified—because the amounts at stake are simply too enormous to justify the risk of litigation. That, in turn, would give rise to more frivolous lawsuits. See Bone & Evans, *Class Certification and the Substantive Merits*, 51 Duke L.J. 1251, 1302 (2002). By requiring proof of materiality and allowing rebuttal prior to class certification, "[t]he law guards against a flood of frivolous or vexatious lawsuits." *Salomon*, 544 F.3d at 484.

3. Careful gatekeeping at the Rule 23 stage protects not only judicial efficiency and fundamental fairness; it also safeguards the productivity of the U.S. economy. In an average year during the past decade, health-care companies representing 18% of that sector's S&P 500 market capitalization were targeted in securities class actions.[6] In 2010, the percentage skyrocketed to nearly 34%. Stanford Clearinghouse at 13. The securities laws are not intended "to provide investors with broad insurance against market losses" in huge segments of our economy. *Dura*, 544 U.S. at 345 (citing *Basic*, 485 U.S. at 252 (White, J., dissenting)). Allowing enormous classes to be certified based on a judicially created presumption where the evidence shows that the statements were immaterial hardly deters fraud. Rather, it punishes innocent defendants (and their current shareholders) who must settle cases after certification to avoid the massive risks and expense of litigation. As this Court declared in *Dura*, a rule that promotes settlement of meritless cases improperly "transform[s] a private securities action into a partial downside insurance policy." *Id.* at 347-348. The Court should not countenance the court of appeals' adoption of such a rule in this case.

The effect is particularly pernicious on smaller companies that invest heavily in research and development to produce the creative breakthroughs that drive our prosperity. Companies with lower revenues or fewer product lines are more susceptible to the stock-price swings that tend to attract securities-fraud lawsuits. And they are

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[6] Stanford Law School Securities Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings: 2011 Year in Review* 13 (2012) (hereinafter, "Stanford Clearinghouse"), http://securities.stanford.edu/clearinghouse_research/2011_YIR/Cornerstone_Research_Filings_2011_YIR.pdf

uniquely vulnerable to the massive costs of defending a class action. Firm enforcement of Rule 23 in securities cases will help ensure that innovation is not stifled by meritless lawsuits.

4. The modesty of the economic reasoning that undergirds *Basic*'s presumption also weighs strongly against weakening Rule 23 safeguards in securities cases. The four-Justice majority in *Basic* invoked the theory with some tentativeness, relying on "common sense," "probability," "recent empirical studies," and the "applau[se]" of three "commentators," 485 U.S. at 246, to conclude only that "[i]t is *not inappropriate* to apply a presumption of reliance supported by the fraud-on-the-market theory." *Id.* at 250 (emphasis added). *Basic*, moreover, rested on an efficient-market theory that was hotly disputed even when *Basic* was decided. For one thing, rather than investors relying on the integrity of the market price—which was *Basic*'s rationale for the adoption of the fraud-on-the-market presumption of reliance—many investors attempt to locate undervalued stocks in an effort to "beat the market," thus "betting that the market for the securities they are buying is in fact inefficient." Macey, *The Fraud on the Market Theory: Some Preliminary Issues*, 74 Cornell L. Rev. 923, 925 (1989). Skepticism has grown since: "Doubts about the strength and pervasiveness of market efficiency are much greater today than they were in the mid 1980s." Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 175 (2009). And the fraud-on-the-market regime established in *Basic* has been criticized for "shift[ing] money from one shareholder pocket to another at enormous expense." Pritchard, Stoneridge Investment Partners *v.* Scientific Atlanta: *The Political Economy of Securities Class Action Reform*, 2008 Cato S. Ct. Rev. 217, 255 (2008). These concerns weigh dispo-

sitively against converting fraud-on-the-market reliance from an ordinary rebuttable presumption to a categorical imperative.

For these reasons, *amici* respectfully suggest that the Court should not further expand the judicially created presumption of reliance that aids plaintiffs who invoke the judicially created Rule 10b-5 cause of action.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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AMICUS CURIAE BRIEF

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Supreme Court of the United States

AMGEN INC., ET AL.,

Petitioners,

—v.—

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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INTEREST OF *AMICI CURIAE*[1]

The 18 *amici curiae* identified in the Appendix to this brief are law professors with scholarly expertise in the areas of civil procedure and securities regulation, and an abiding interest in the sensible development and application of the law. They respectfully submit this brief to assist the Court.

Amici civil-procedure professors agree with Respondent that proof of materiality is neither required nor appropriate at the class-certification stage to assure that common questions predominate under Rule 23(b)(3). When a defendant makes a public misstatement, the objective materiality of that misstatement, under this Court's reasonable-investor standard, is a common question for the entire class, to be determined on the merits. This conclusion is supported by the history of Rule 23, which demonstrates that Rule 23(b)(3)'s drafters had securities-fraud class actions specifically in mind when framing the 1966 Amendments to Rule 23.

Amici securities-law professors agree that materiality need not be proved at the class-certification stage. Under the fraud-on-the-market theory adopted in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), when securities trade in an open and developed or "efficient" market, reliance converges with the objective, common question of whether the statement was material. This conclusion is supported by the history of the fraud-on-the-market presumption and

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[1] The parties have filed blanket consents to the filing of *amicus curiae* briefs. No counsel for any party authored this brief in whole or in part. No party or its counsel made any contribution to fund the preparation or submission of this brief. No person other than the *amici curiae* or their counsel has made a monetary contribution to the preparation or printing of this brief.

by the federal securities laws' focus on stemming the manipulation of securities prices and ensuring honest markets. Because materiality is an element of liability, moreover, a failure to show materiality cannot cause individual issues of reliance to predominate, as one who relies on an immaterial misstatement has no claim.

SUMMARY OF ARGUMENT

Petitioners and their *amici* would have this Court assume that class actions for securities fraud perpetrated on vast numbers of investors are a surprising anomaly, made possible only by this Court's decision in *Basic*, which they portray as relying upon an extreme conception of market "efficiency" to fashion its presumption of investors' reliance on securities markets' integrity.

In truth, however, Rule 23(b)(3)'s drafters had securities-fraud class actions specifically in mind when they framed the 1966 Amendments to Rule 23 in order to liberalize class proceedings' availability. The Advisory Committee Note says so. And the federal courts appropriately certify fraud class actions involving similar misrepresentations or a single cause of fraudulent conduct.

Basic's holding that objective materiality raises an inference of effect on the market prices on which investors rely developed against a backdrop of precedent recognizing that materiality supports an inference of reliance, even as it serves as an objective check. But the premise that a failure of materiality would require individualized determinations of whether each class member relied upon misstatements is unfounded. For if statements are immaterial, individual class members' reliance upon them is irrelevant – since one who relies on an immaterial statement has no claim. And to the extent that misinformation is not reflected in stock price, plaintiff class members are not harmed.

The principles underlying *Basic* are rooted in the law and economics of market manipulation entirely familiar to §10(b)'s framers. Congress targeted stock-market fraud and manipulation against the backdrop of both judicial decisions and legal scholarship recognizing that investors are defrauded when market prices are subject to manipulation by false statements. The very text of §10(b) targets "any *manipulative* or deceptive device or contrivance." 15 U.S.C. §78j(b) (emphasis added). And though two law professors have filed an *amicus* brief asserting that *Basic*'s holding rests upon an unrealistically strict conception of market efficiency,[2] this Court's opinion says that "[b]y accepting this rebuttable presumption, we do not intend conclusively to adopt any particular theory of how quickly and completely publicly available information is reflected in market price." *Basic*, 485 U.S. at 249 n.28. "Because *most* publicly available information is reflected in market price," this Court held, "an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action." *Id.* at 247 (emphasis added). Thus, the two professors' quibbles about the literal accuracy of the Efficient Capital Market Hypothesis are quite beside the point.

ARGUMENT

I. Rule 23(b)(3)'s Framers Sought to Facilitate Securities-Fraud Class Actions

Petitioners' assumption that securities-fraud cases are, generally speaking, ill-suited to class treatment under Rule 23 ignores the Rule's very history and purpose.

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[2] *See Brief of Law Professors as Amici Curiae in Support of Petitioners* at 1, filed on behalf of Professors Adam C. Pritchard and M. Todd Henderson.

Although this Court had long recognized and approved the class-action device,[3] the original Rule 23's adoption in 1938 was intended "to encourage more frequent use of class actions."[4] Shortly after the original Rule 23's promulgation, influential commentators appreciated the class action's promise for securities regulation through private litigation.[5] So did federal courts, as they recognized private rights of action in the federal securities laws.[6] Throughout the 1938-1966 era, courts routinely approved Rule 23's use in cases grounded upon a common course of misrepresentation or fraud.[7]

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[3] *See, e.g., Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356, 367 (1921); *Smith v. Swormstedt*, 57 U.S. (16 How.) 288, 302-03 (1853).

[4] Charles Alan Wright, Arthur M. Miller & Mary Kay Kane, *Federal Practice and Procedure: Civil 3d* §1752 at 18 (2005).

[5] Harry Kalven, Jr. & Maurice Rosenfield, *The Contemporary Function of the Class Suit*, 8 U. Chi. L. Rev. 684, 684-87 (1941). For this article's influence, *see, e.g., Am. Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 547 n.12 (1974); *Snyder v. Harris*, 394 U.S. 332, 351 n.15 (1969); *Dickinson v. Burnham*, 197 F.2d 973, 981 n.4 (2d Cir. 1952) (Clark, J.).

[6] The first recognition of a private right of action came in *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946). *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 n.10 (1982). For an example of an approved securities-fraud class action in the wake of *Kardon*, *see, e.g., Speed v. Transamerica Corp.*, 99 F. Supp. 808, 833 (D. Del. 1951).

[7] *See, e.g., Escott v. Barchris Constr. Corp.*, 340 F.2d 731, 733 (2d Cir. 1964); *Amen v. Black*, 234 F.2d 12, 16 (10th Cir. 1956); *Zahn v. Transamerica Corp.*, 162 F.2d 36, 49-50 (3d Cir. 1947); *Oppenheimer v. F. J. Young & Co.*, 144 F.2d 387, 390 (2d Cir. 1944); *York v. Guar. Trust Co.*, 143 F.2d 503, 528 (2d Cir. 1944), *rev'd on other grounds*, 326 U.S. 99 (1945); *Independence Shares Corp. v. Deckert*, 108 F.2d 51, 55 & n.1 (3d Cir. 1939), *rev'd in part on other grounds*, 311 U.S. 282, 287-88 (1940) (re-

The modern class action dates to the Federal Civil Rules Advisory Committee's 1966 revision of Rule 23 to expand the device's range and force.[8] By the time the Committee began its deliberations, Rule 23's importance to securities enforcement was indisputable. The Ninth Circuit expressed a widely shared sentiment in 1964 when it adopted Professor Moore's observation that "Class actions under Rule 23(a)(3) have 'proved useful where a large number of purchasers or holders of securities claim to have been defrauded by a common course of dealing on the part of the defendants.'"[9] Quoting Professor Loss's leading treatise on *Securities Regulation*, the court added "'the ultimate effectiveness of the federal remedies' in this area 'may depend in large measure on the applicability of the class action device.'"[10] The Securities and Exchange Commission ("SEC") agreed that "[t]he availability of the representative suit for class actions on behalf of investors similarly situated . . . has contributed substantially to the feasibility of prosecution by investors of causes of actions

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versing Third Circuit's holding that relief was limited to damages only, sustaining the district court's equitable "power to make effective the right of recovery" where "petitioners' bill states a cause of action tested by the customary rules governing suits of this character" and a defendant "is threatened with many law suits"), *on remand sub nom., Pa. Co. for Ins. on Lives etc. v. Deckert*, 123 F.2d 979, 983 (3d Cir. 1941) ("if a corporation engaged in the sale of stock by fraudulent means to a number of individuals, under rule 23(a)(2) they might join together as parties-plaintiff in one action to avoid a multiplicity of suits").

[8] *See Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 833 (1999) ("modern class action practice emerged in the 1966 revision of Rule 23").

[9] *Harris v. Palm Springs Alpine Estates, Inc.*, 329 F.2d 909, 913 (9th Cir. 1964) (quoting 3 James Wm. Moore, *Moore's Federal Practice* ¶23.10 (2d ed. 1963)).

[10] *Harris*, 329 F.2d at 913 (quoting 3 Louis Loss, *Securities Regulation* 1819-20 (2d ed. 1961)).

based on violations of the federal securities laws."[11] The SEC hoped that courts would not misconstrue the revised Rule "to impose unwarranted obstacles" to securities class actions.[12]

Consistent with this broadly shared appreciation for the class action's role, the Committee drafted Rule 23(b)(3) with securities cases as a model.

The Advisory Committee Note to the 1966 amendments itself identifies "a fraud perpetrated on numerous persons by the use of similar misrepresentations" as "an appealing situation for a class action," even when the case involves individual issues as to injury and damages suffered.[13] Thus, if a case involves reliance on "similar representations," or where plaintiffs complain that material facts were concealed from all, common questions would predominate, and the case would be appropriate for class treatment. Citing the Advisory Committee Note, this

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[11] Memorandum of Securities and Exchange Commission With Respect to Amendments to Rule 23 of the Federal Rules of Civil Procedure, at 2, 4 (May 7, 1965), *in* Records of the U.S. Judicial Conference, *microfilmed at* Cong. Inf. Serv., CI-7010-77.

[12] *Id.*

[13] Fed. R. Civ. P. 23(b)(3), Advisory Committee Note to 1966 Amendment; *see* 39 F.R.D. at 103. The Advisory Committee Note to subdivision (c)(4)'s provision that "an action may be maintained as a class action with respect to particular issues," Fed. R. Civ. P. 23(c)(4), added that "in a fraud or similar case the action may retain its 'class' character only through the adjudication of liability to the class; the members of the class may thereafter be required to come in individually and prove the amounts of their respective claims." Fed. R. Civ. P. 23(c)(4), Advisory Committee Note to 1966 Amendment; *see* 39 F.R.D. 69, 106 (1966). Thus, the Advisory Committee clearly understood that the merits of many fraud cases are properly subject to initial class-wide proof.

Court rightly noted in *Amchem Prods. v. Windsor*, 521 U.S. 591, 625 (1997), that predominance "is a test readily met" in cases alleging securities fraud.

The Advisory Committee Note concedes that, "although having some common core, a fraud case may be unsuited for treatment as a class action if there was material variation in the representations made or in the kinds or degrees of reliance by the persons to whom they were addressed."[14] Courts at the time of the revision understood this to mean that common issues might not predominate where the defendant's oral communications varied significantly from one class member to the next.[15] The Committee intended this exception to be quite narrow. In his oft-cited article on the amended rule, Committee reporter Professor Benjamin Kaplan confirmed that "[t]he Advisory Committee forecast that cases of fraudulent misrepresentation or antitrust violations would be likely, although not by any means sure candidates for class treatment under subdivision (b)(3)."[16] He cited *York*, 143 F.2d 503, as "illustrative" of Rule 23(b)(3)'s proper deployment. There, the Second Circuit allowed class proceedings, even though the plaintiffs could not rule out the possibility that evi-

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[14] *Id.*

[15] *E.g.*, *Morris v. Burchard*, 51 F.R.D. 530, 533-35 (S.D.N.Y. 1971); *but cf. Fischer v. Kletz*, 41 F.R.D. 377, 382-83 (S.D.N.Y. 1966) (certifying a securities fraud class under Rule 23(b)(3) even though the defendant made different statements at different times, and the class members made purchases based on different representations).

[16] Benjamin Kaplan, *Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (I)*, 81 Harv. L. Rev. 356, 393 (1967). For examples of this Court's citations to Professor Kaplan's article, see *Ortiz*, 527 U.S. at 833, *Amchem*, 521 U.S. at 613-14, *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 809 & 813 n.4 (1985), and *Oppenheimer Fund v. Sanders*, 437 U.S. 340, 356 n.21 (1978).

dence of causation might differ from one class member to another.[17]

Federal courts from the late 1960s onward have respected the Advisory Committee's intentions and applied Rule 23 to permit class certification in securities-fraud cases. "[T]he new rule is designed to expand the situations in which a class action is appropriate," the Tenth Circuit observed in a 1968 securities case, and to "favor . . . the maintenance of the class action."[18] Throughout Rule 23's modern era, courts often have found that common questions predominate where a single course of fraudulent conduct has many victims, notwithstanding various individualized issues that a crabbed treatment of the device might stress.[19]

As the Ninth Circuit observed in its 1975 *Blackie v. Barrack*[20] opinion: "Confronted with a class of purchasers allegedly defrauded over a period of time by similar misrepresentations, courts have taken the common sense approach that the class is united by a common interest in determining whether a defendant's course of conduct is in its broad outlines actionable, which is not defeated by slight differences in class members' positions."[21] An influential early opinion on Rule 23's use in securities cases got

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17 *York*, 143 F.2d at 528.

18 *Esplin v. Hirschi*, 402 F.2d 94, 99-100 (10th Cir. 1968); *see also Green v. Wolf Corp.*, 406 F.2d 291, 298 (2d Cir. 1968) (quoting *Esplin*).

19 *See, e.g., In re First Alliance Mortg. Co.*, 471 F.3d 977, 990-91 (9th Cir. 2006); *In re Prudential Ins. Co. of America, Sales Practice Litig.*, 148 F.3d 283, 290 (3d Cir. 1998); *Korn v. Franchard Co.*, 456 F.2d 1206, 1212-14 (2d Cir. 1972); *Green*, 406 F.2d at 300-01; *Esplin*, 402 F.2d at 99-100.

20 524 F.2d 891 (9th Cir. 1975).

21 *Id.* at 902.

it right: to approach the class-certification question in securities cases otherwise would "emasculate" the class-action device.[22]

Frauds "perpetrated on numerous persons by the use of similar misrepresentations" have always lain and continue to lie in Rule 23's wheelhouse. Few such cases are better suited to class treatment than those where it is alleged that a given security's market price had been fraudulently manipulated.

II. The Common Law of Deceit and the Rise of the Fraud-on-the-Market Theory

One reason why fraud claims may be readily susceptible to class-wide proof is that even the common law permitted plaintiffs' reliance to be inferred circumstantially, without their direct testimony, from a misrepresentation or omission's material falsity. Federal courts have rightly concluded that such inferences also are warranted in order to give the federal securities laws their intended effect.

When *Pasley v. Freeman*[23] recognized an independent action for deceit in 1789, the court held "'an action upon the case for a deceit lies when a man does any deceit to the damage of another.'"[24] This Court has long recognized an action for fraud thus generally lies whenever words or conduct are employed to mislead another to his or her det-

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22 *Dolgow v. Anderson*, 43 F.R.D. 472, 481 (E.D.N.Y. 1968); *see also Green*, 406 F.2d at 301 ("Carried to its logical end, [an undue focus on individualized issues] would negate any attempted class action under Rule 10b-5 . . . .").

23 [1789] 3 Term Rep. 51, 100 Eng. Rep. 450 (K.B.).

24 *Id.*, 3 Term Rep. at 64, 100 Eng. Rep. at 457 (per Lord Kenyon, Ch. J.; quoting Lord Ch. B. John Comyns, *Digest of the Laws of England*).

riment -- no matter how the deception is in fact accomplished.[25] In *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005), this Court found support for §10(b)'s loss-causation requirement in *Pasley's* rule that "if 'no injury is occasioned by the lie, it is not actionable: but if it then be attended with a damage, it then becomes the subject of an action.'"[26]

The common law's elements of "reliance" and "materiality" were developed to make the principle effective. Reliance, in particular, ensures a causal connection between deceit and injury.[27] Indeed, the *Restatement* captions the reliance element as "Causation in Fact."[28]

Petitioners and their *amici* suggest that establishing this causal connection ordinarily should require individualized proof, and even testimony from every class member. Yet when the action was first recognized, and into the nineteenth century's latter half, common-law rules of evi-

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[25] *See Stewart v. Wyo. Cattle Ranche Co.*, 128 U.S. 383, 388 (1888).

[26] *Dura*, 544 U.S. at 344 (2005) (quoting *Pasley*, 3 Term Rep. at 65, 100 Eng. Rep. at 457).

[27] *See* 2 Fowler V. Harper, Fleming James, Jr. & Oscar S. Gray, *The Law of Torts* §7.13 at 464-65 (2d ed. 1986); Leon Green, *Deceit*, 16 Va. L. Rev. 749, 762 (1930).

[28] **§546. Causation in Fact**

> The maker of a fraudulent misrepresentation is subject to liability for pecuniary loss suffered by one who justifiably relies upon the truth of the matter misrepresented, if his reliance is a substantial factor in determining the course of conduct that results in his loss.

Restatement (Second) of Torts §546 (1977). The *Restatement's* commentary explains: "For a misrepresentation to be a cause in fact of the pecuniary loss that results from the plaintiff's action or inaction, the plaintiff must have relied upon the misrepresentation in incurring the loss." *Id.*, cmt. b.

dence *barred* the parties from testifying.[29] Under the common-law rules, reliance had to be shown without the benefit of the plaintiff's testimony, typically being inferred from evidence showing that a misrepresentation was made, and that the plaintiff took action *consistent with* reliance upon it – that is, by entering a transaction to which the misrepresentation related.[30]

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[29] John T. Loughran, *Evidence* §136, at 380, in 10 *Modern American Law* (1917) ("The parties to a suit and others interested in the event of a litigation were incompetent witnesses because it was feared that their interests in the suit might tempt them to disregard their oaths."); James Fitzjames Stephen, *A Digest of the Law of Evidence* 168 (London: MacMillan & Co., 1876) ("At Common Law the parties and their husbands and wives were incompetent in all cases."); Dale A. Nance, *The Best Evidence Principle*, 73 Iowa L. Rev. 227, 255 n.145 (1988) (citing danger of perjury as the rule's rationale); John H. Wigmore, *Looking Behind the Letter of the Law*, 4 U. Chi. L. Rev. 259, 262-63 (1937) (same); *see also* 4 Jeremy Bentham, *Rationale of Judicial Evidence, Specially Applied to English Practice* 104 (London: Hurt & Clark, 1827) (criticizing the common-law rule); Society for Promoting the Amendment of the Law, *Report of the Committee of Common Law on Evidence of Parties* (London: 1848) (urging reform permitting parties to testify).

[30] *Ste. Marie v. Wells*, 93 Vt. 398, 108 A. 270, 270 (1919) ("*Pasley v. Freeman* . . . is the case generally regarded as the foundation of the modern law of actionable misrepresentation. At the time that decision was rendered (1789) the parties to a suit were by the common law disqualified as witnesses because of their interest in the outcome of the litigation. . . . So it appears that the principle that reliance, in fraud cases, might be inferred from the circumstances was one of early inception."); *Smith v. Chadwick*, [1884] H.L. 9 App. Cas. 187 at 196, All E. R. Rep 242 at 247 (per Lord Blackburn: "I do not think it is necessary . . . that the plaintiff always should be called as a witness to swear that he acted upon the inducement. At the time when *Pasley v Freeman* . . . was decided, and for many years afterwards, he could not be so called. I think that if it is

But if misrepresentations amount to something about which no one could reasonably care, it is unlikely that they induced reliance or caused genuine harm.[31] Common-law decisions permitting reliance to be circumstantially inferred thus demanded that the reliance be "justifiable," requiring plaintiffs to show that "fraud was an inducing cause to the contract, for which purpose it must be material."[32]

Materiality accordingly functions both as a circumstantial indicator of, and as an objective check on, subjective reliance. "The notion of justifiable reliance is limited by the rule of materiality: Even a fraudulent misrepresentation is not actionable if the representation is 'immaterial.'"[33] Or, as the *Restatement (Second)* puts it: "Reliance upon a fraudulent misrepresentation is not justifiable unless the matter misrepresented is material."[34]

Nineteenth-century evidence codes and twentieth-century rules of evidence eventually established the plain-

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proved that the defendants, with a view to induce the plaintiff to enter into a contract, made a statement to the plaintiff of such a nature as would be likely to induce a person to enter into a contract, and it is proved that the plaintiff did enter into the contract, it is a fair inference of fact that he was induced to do so by the statement.").

[31] *See* W. Page Keeton, *et al.*, *Prosser & Keeton on the Law of Torts* §108 at 753 (5th ed. 1984) ("There are misstatements which are so trivial, or so far unrelated to anything of real importance in the transaction, that the plaintiff will not be heard to say that they substantially affected his decision.").

[32] *See Smith*, 9 App. Cas. at 190 (per Lord Selborne L.C.); *see id.* at 195 (per Lord Blackburn).

[33] Harper, James & Gray, *The Law of Torts*, *supra* note 27, §7.9 at 435; *see also* William Williamson Kerr, *A Treatise on the Law of Fraud and Mistake* 39-40 (3d ed. 1902).

[34] Restatement (Second) of Torts §538(1) (1977).

tiff's right to testify.[35] Yet common-law reliance still may be inferred without the plaintiff's direct testimony, based rather upon a statement's objective materiality.[36] This,

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[35] *See, e.g.*, Fed. R. Evid. 601, 1972 Advisory Committee Note ("among the grounds [for testimonial incompetency] thus abolished are . . . connection with the litigation as a party or interested person or spouse of a party or interested person"); Stephen, *Digest of the Law of Evidence*, *supra* note 29, at 168-69 ("This incompetency was removed as to the parties . . . by 14 & 15 Vict. c. 99, s.2; and as to their husbands and wives, by 16 & 17 Vict. c. 83, ss. 1, 2.").

[36] *See Vasquez v. Superior Court*, 4 Cal. 3d 800, 814, 484 P.2d 964, 972 (1971) ("The rule in this state and elsewhere is that it is not necessary to show reliance upon false representations by direct evidence. 'The fact of reliance upon alleged false representations may be inferred from the circumstances attending the transaction which oftentimes afford much stronger and more satisfactory evidence of the inducement which prompted the party defrauded to enter into the contract than his direct testimony to the same effect.'") (quoting *Hunter v. McKenzie*, 197 Cal. 176, 185, 239 P. 1090, 1094 (1925)); *Enequist v. Bemis*, 115 Vt. 209, 214, 56 A.2d 617, 621 (1947) ("[I]n absence of direct testimony on this point, where the representation is of such a nature as would induce a person to enter a contract, and he does so, it is a fair inference, which the jury may draw, that reliance was placed thereon."); *see also De Cicco v. Schweizer*, 221 N.Y. 431, 438, 117 N.E. 807, 809 (1917) ("'If it is proved that the defendants with a view to induce the plaintiff to enter into a contract made a statement . . . of such a nature as would likely induce a person to enter the contract, it is a fair inference of fact that he was induced to do so by the statement.'") (quoting *Smith*, 9 App. Cas. 187); *Taylor v. Guest*, 58 N.Y. 262, 266 (1874) ("It is incumbent upon the party claiming to recover in an action for deceit, founded upon false representations, to show that he was influenced by them. It does not require very strong proof to establish it. In most cases it may be inferred from the circumstances attending the transaction."); *Ste. Marie*, 93 Vt. at 399-400, 108 A. at 270-71 ("The plaintiff did not testify in terms that he acted in reliance upon defendant's representations in the purchase of the farm. But there is ample authority for the proposition that the fact of reliance need not be proved by direct

quite obviously, may facilitate class treatment where similar misrepresentations are made to members of a class who have then entered similar transactions. Thus, federal courts have readily certified class actions for fraud, as intended by Rule 23(b)(3)'s framers. *See supra* 5-9.

This Court has, of course, made both reliance and materiality elements of a §10(b) claim. *See Erica P. John Fund, Inc. v. Halliburton Co.*, __ U.S. __, 131 S. Ct. 2179, 2184 (2011) (listing elements); *Matrixx Initiatives, Inc. v. Siracusano*, __ U.S. __, 131 S. Ct. 1309, 1317 (2011) (same).

It permitted inferences of reliance from materiality in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972). In a case involving failure to make full disclosures in certain face-to-face transactions, this Court held "[a]ll that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision." *Id.* at 153-54. "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery," as an obligation to disclose and the "withholding of a material fact establish the requisite element of causation in fact." *Id.*

Lower courts soon recognized that a similar inference may be drawn in cases where false statements manipulated an actively traded security's market price. The early cases explained that for transactions in an active securities market, an inference of reliance naturally follows from a showing that public statements were materially misleading. "Materiality circumstantially establishes the re-

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evidence, but may be inferred from the circumstances; and where the representations complained of are material and of a nature calculated to induce the person to whom they are made to take a certain course of action with regard to the subject-matter of the representations, the question whether he relied thereon in so doing is one of fact for the jury.").

liance of some market traders and hence the inflation in the stock price – when the purchase is made the causational chain between defendant's conduct and plaintiff's loss is sufficiently established to make out a prima facie case." *Blackie*, 524 F.2d at 906. Because securities markets tend to respond to public information, materiality allowed the inference that the misrepresentations likely affected stock price, which in turn implied reliance (a causal link between misrepresentation and injury). *See id.*

In *Panzirer v. Wolf*, 663 F.2d 365, 367 (2d Cir. 1981), *vacated on other grounds sub nom., Price Waterhouse v. Panzirer*, 459 U.S. 1027 (1982), where statements appeared in the financial press, the Second Circuit relied on both *Affiliated Ute* and *Blackie* to conclude that where the alleged "fraud consists of a failure to disclose, the difficult nature of plaintiff's claim – that if there had been disclosure, plaintiff would not have been harmed – has led the Supreme Court to hold that if the omission is material, reliance upon the omission will be presumed." *Id.* at 368.

In *Lipton v. Documation, Inc.*, 734 F.2d 740, 748 (11th Cir. 1984), the Eleventh Circuit agreed with *Blackie*, that "reliance may be presumed where securities are traded on the open market." In *Harris v. Union Elec. Co.*, 787 F.2d 355, 367 (8th Cir. 1986), the Eighth Circuit relied on *Affiliated Ute* to hold that "[b]ecause the plaintiffs' complaint consists primarily of allegations of a failure to adequately disclose . . ., reliance in this case can be inferred from materiality." And the Third Circuit held in *Peil v. Speiser*, 806 F.2d 1154, 1161 (3d Cir. 1986), that open-market securities purchasers "need not prove direct reliance," but only "that the defendants made material misrepresentations."

Relying on this history, *Basic* adopted the fraud-on-the-market presumption, replacing individualized questions of direct reliance with reliance on the market price. Noting

arguments "that reliance is and long has been an element of common-law fraud," this Court "agree[d] that reliance is an element of a Rule 10b-5 cause of action," as well. 485 U.S. at 243. "Reliance," *Basic* held, "provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury." *Id.*

"There is, however, more than one way to demonstrate the causal connection." *Id.* "'Misleading statements will . . . defraud purchasers of stock even if the purchasers do not directly rely on the misstatements.'" *Id.* at 241-42 (citation omitted). Thus, "'the dissemination of material misrepresentations or withholding of material information typically affects the price of the stock, and purchasers generally rely on the price of the stock as a reflection of its value.'" *Id.* at 244 (citation omitted).

Basic held a statement (or omission) is material if a "reasonable investor" would view it as affecting the "total mix" of available information. *Id.* at 231-32. "Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be over- or underinclusive." *Id.* at 236. Thus, suggestions that materiality only can be determined by showing statistically significant price movements are mistaken, and exclusive reliance on "event studies" to measure a statements' effect on price can be problematic.[37]

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[37] *See* Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 180 (2009) ("If we assume that markets often over- or under-react to news (and pseudonews) and sometimes develop troublesome bubbles where price strays from intrinsic value, then the simple statistical showing of an impact cannot so easily be treated as a precise measure of either the omitted information or the defendant's responsibility. In other words, the event study no longer offers a clean assessment of the intrinsic value of the fraud because

Far from implicating any individual issues of subjective reliance, however, "[t]he question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor." *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 445 (1976). That makes it a common question, subject to common proof at trial.

Though proof of materiality supports an inference of reliance under *Basic*, failure of materiality would not, as Petitioners and their *amici* assume, require further individualized proof of reliance. If statements are not material, there is no point in proving individualized reliance on them – as investors who rely on an immaterial misstatement have no claim in any event. *See Basic*, 485 U.S. at 231-32 (holding that materiality is an essential element of *any* §10(b) claim). Thus, a case such as this would not produce individualized issues of reliance if the misrepresentations at issue turned out to be immaterial.

III. Congress Framed §10(b) in Light of Market-Manipulation Principles Recognizing that False Statements Inflating Securities Markets Operate to Defraud All Who Purchase at the Affected Prices and Then Suffer a Loss

Petitioners and their *amici* would have this Court believe that *Basic*'s holding that investors may rely on the integrity of America's securities markets rests upon, and is limited by, strict validity of the Efficient Capital Market Hypothesis, framed by economists and tested in the 1970s,

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noise and sentiment can influence price as well, hence the econometrician's ability to discipline the litigation process diminishes.").

which they insist requires *instantaneous* and *complete* incorporation of *all* public information in a security's market price. In truth, *Basic*'s holding is well-grounded in the framing Congress's understanding of securities markets, and of false statements' capacity to manipulate those markets, even if adjustments are not always instantaneous. Even Petitioners' *amici* agree that strict efficiency should not be required – and about that, at least, they are right.

Section 10(b), by its plain terms, is framed to address the use "in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance," 15 U.S.C. §78j(b), and this Court holds "a §10(b) action can be brought by a purchaser or seller of '*any* security' against '*any* person' who has used '*any* manipulative or deceptive device or contrivance' in connection with the purchase or sale of a security." *Herman & MacLean*, 459 U.S. at 382 (Court's emphasis).

The statutory text and implied cause of action are thus plainly rooted in the law of market manipulation and deceit. "The meaning the Court has given the term 'manipulative' is consistent with the use of the term at common law," according to *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 7 (1985), and the Court often has noted §10(b)'s affinity with §9 of the Securities Exchange Act of 1934 ("Exchange Act"), which outlaws a variety of manipulative practices.[38]

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[38] *See, e.g., Musick, Peeler & Garrett v. Emp'rs Ins.*, 508 U.S. 286, 295-96 (1993); *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 360-61, 364 n.9 (1991); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 494 (1977).

What does "manipulation" mean? It means that misleading statements or actions can be employed to distort prices from what would have prevailed in their absence.[39]

At the time Congress legislated against "any manipulative or deceptive device or contrivance," the seminal decision on market manipulation was *Rex v. De Berenger*,[40] an English case that this Court had cited favorably to find bid-rigging agreements against public policy in *McMullen v. Hoffman*.[41] *De Berenger* also figured quite prominently in the 1933 American market-manipulation precedent *United States v. Brown*,[42] which has itself informed this Court's understanding of what manipulative devices the Exchange Act proscribes.[43]

De Berenger involved an early fraud on the market for British securities. Lord Cochrane and several others were convicted of a conspiracy to spread false rumors on February 19, 1814, that Napoleon Bonaparte had died, thus "unlawfully contriving, etc. by false reports, rumours, arts, and contrivances," to induce the public to think that peace

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39 *See generally* Jill E. Fisch, *The Trouble with Basic: Price Distortion after Halliburton*, __ Wash. U. L. Rev. __ (2013) (publication forthcoming April 2013).

40 [1814] 3 Maule & Selwyn 67, 105 Eng. Rep. 536 (K.B.), All E.R. Rep. 513; *see* 8 Louis Loss, Joel Seligman & Troy Paredes, *Securities Regulation* 517-19 (4th ed. 2012). The Earl of Birkenhead placed the *De Berenger* case prominently among his *Famous Trials of History*. *See* Earl of Birkenhead, *Famous Trials of History* 196-208 (1926).

41 174 U.S. 639, 649 (1899).

42 5 F. Supp. 81, 85-88 (S.D.N.Y. 1933), *aff'd*, 79 F.2d 321 (2d Cir. 1935); *cf.* Adolph A. Berle, Jr., *Stock Market Manipulation*, 38 Colum. L. Rev. 393, 395-96 (1938) (discussing "the now famous case of *United States v. Brown*").

43 *See Schreiber*, 472 U.S. at 7 (quoting *Brown*, 5 F. Supp. at 85).

with France was imminent.[14] This caused "a great increase and rise of the government funds and government securities" of Britain – to the injury of all "who should on the 21st of February [1814] purchase and buy any part or parts, and share or shares of and in the said public Government funds."[15]

In words that this Court repeated in *McMullen*, Lord Ellenborough declared that such conduct "strikes at the price of a vendible commodity in the market, and if it gives it a fictitious price by means of false rumours, it is a fraud levelled against all the public, for it is against all such as may possibly have anything to do with the funds on that particular day."[16] The King's Bench was unanimous in so holding.[17]

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[14] *De Berenger*, 3 Maule & Selwyn at 68, 105 Eng. Rep. at 537 (syllabus).

[15] *Id.*

[16] *McMullen*, 174 U.S. at 649 (quoting *De Berenger*, 3 Maule & Selwyn at 72-73, 105 Eng. Rep. at 538) (Lord Ellenborough, Ch. J.); *see also Brown*, 5 F. Supp. at 85-86; *Morris Run Coal Co. v. Barclay Coal Co.*, 68 Pa. 173, 187-88 (1871); *State v. Buchanan*, 5 H. & J. 317, 348 (Md. App. 1821).

[17] Judge LeBlanc agreed that the "object was to injure all those who should become purchasers on that day, and not some individuals in particular." *De Berenger*, 3 Maule & Selwyn at 74, 105 Eng. Rep. at 539 (LeBlanc, J.). Judge Bayley declared that deceptive conduct affecting the prices at which securities trade "will certainly prejudice a large portion of the King's subjects who have occasion to purchase on that day," its "necessary consequence" being "to prejudice all those who become purchasers during the period of that fluctuation." *Id.*, 3 Maule & Selwyn at 75, 105 Eng. Rep. at 539 (Bayley, J.). Judge Dampier recited the charge, "that the defendants by false rumours conspired to give a temporary rise to the funds of this Kingdom, in order to deceive those persons who should purchase into the funds on a particular day," and then summed up: "The means used are wrong, they were false rumours; the object is wrong, it

From false rumors influencing securities' prices, the precedents proceeded to deceptive acts and transactions similarly designed to affect market prices, but by creating the false appearance of active trading. This Court observed in *Schreiber* that the "seminal English case of *Scott v. Brown, Doering, McNab & Co.*, [1892] 2 Q. B. 724 (C. A.), which broke new ground in recognizing that manipulation could occur without the dissemination of false statements," was one that nevertheless "placed emphasis on the presence of deception" created by the appearance of active trading in the market. *Schreiber*, 472 U.S. at 7 n.4. "As Lord Lopes stated in that case, 'I can see no substantial distinction between false rumours and false and fictitious acts.'" *Id.* (quoting *Scott*, [1892] 2 Q.B. at 730 (Lord Lopes)). Or, as the district court put it in *Brown*: "'[Even] a speculator is entitled not to have any present fact involving the subject matter of his speculative purchase or the price thereof misrepresented by word or act.'" *Schreiber*, 472 U.S. at 7 n.4 (quoting *Brown*, 5 F. Supp. at 85) (*Schreiber*'s brackets); *see also Willcox v. Harriman Sec. Corp.*, 10 F. Supp. 532, 535 (S.D.N.Y. 1933).

The concept of manipulation thus had by 1892 come to include not just misleading statements and rumors disseminated on a public market, as in *De Berenger*, but also "practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity,"[18] which Exchange Act §9 and §10(b) together proscribe.[19] Such schemes all involve

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was to give a false value to a commodity in the public market, which was injurious to those who had to purchase." *Id.*, 3 Maule & Selwyn at 76-77, 105 Eng. Rep. at 540 (Dampier, J.).

[18] *Santa Fe*, 430 U.S. at 476.

[19] *See* Berle, *Stock Market Manipulation*, 38 Colum. L. Rev. at 398-400. A "wash sale" is an ostensible market transaction in which a security's owner has in truth merely "sold shares on the stock exchange to himself," while with "matched

deception affecting the entire market – just as the false statements in *De Berenger* did – giving rise to claims on behalf of all to transact at the affected prices. *See* 15 U.S.C. §78i(f) ("[a]ny person who willfully participates . . . shall be liable to any person who shall purchase or sell any security at a price which was affected").

The 1934 Congress's understanding of stock-market fraud and manipulation doubtless was grounded as well in contemporary legal scholarship. Among the era's greatest authorities on corporate finance and securities markets was Professor Adolph A. Berle, Jr. of the Columbia University School of Law, a member of Franklin Roosevelt's "Brain Trust,"[50] whose 1931 article on *Liability for Stock Market Manipulation* laid out the fundamentals of what *Basic* embraced as the "fraud on the market" theory of reliance.[51]

Professor Berle wrote that "all markets move in a nexus of information gathered from all sources and circulated in a variety of ways, recognized and unrecognized."[52] Thus, if a publicly traded company issues false statements affect-

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orders" the "conspirators shuttle the stock back and forth between each other" to produce market quotations and the appearance of active trading. *Id.* at 394-95.

[50] *The Yale Biographical Dictionary of American Law* 39-40 (Roger K. Newman, ed., 2009); James Stuart Olson, *Historical Dictionary of the Great Depression, 1929-1940* 32-33 (2001); Adam Cohen, *Nothing to Fear: FDR's Inner Circle and the Hundred Days that Created Modern America* 60-63 (2009).

[51] *See* Adolph A. Berle, Jr., *Liability for Stock Market Manipulation*, 31 Colum. L. Rev. 264, 268-70 (1931); *Willcox v. Harriman Sec. Corp.*, 10 F. Supp. 532, 535 (S.D.N.Y. 1933) (citing Professor Berle's article to sustain private claims for market manipulation); *see also* Berle, *Stock Market Manipulation*, 38 Colum. L. Rev. at 393-94 & nn.3-6, 395-97, 399-400.

[52] Berle, *Liability for Stock Market Manipulation*, 31 Colum. L. Rev. at 268.

ing the price of its securities, "any purchaser in the market would seem to have an action in deceit or fraud for damage suffered there from."[53] "If the X corporation states that its earnings are $13 a share when, in fact, its income statement should really show a loss, and the market estimates the value of the stock at $130 on the basis of such statement, and the investor buys at the market price, he has relied on the market situation, which in turn resulted from the false statement."[54]

If someone "circulates a false report as to the earnings of a particular corporation which affects the price of its stock," Professor Berle continued, "relief may be had against him by any person buying or selling in the market, where it appears that the report was designed to affect the market."[55]

> It may be asked if this is a variation of the common law rule that the statement must be intended to be relied upon. Obviously not; for while the maker of the false representation has not singled out a specific individual for his victim, he has tossed his squib into a crowd, one or

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53 *Id.* at 268-69 (footnotes omitted).

54 *Id.* at 269-70. *See* Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 Stan. L. Rev. 385, 407 n.96 (1990) ("Writing in 1931, Adolf Berle, probably the era's most influential commentator on corporate finance, asserted that courts had already gone much further than [is] commonly assumed to protect the stock market from fraud.").

55 Berle, *Liability for Stock Market Manipulation*, 31 Colum. L. Rev. at 270.

> many of whom may be hit; and this fact is, or at least should be, known to him.[56]

"The intellectual patrimony of the Securities Exchange Act," Judge Richard A. Posner observed in a Seventh Circuit decision construing §10(b), also "includes Berle and Means' influential book (published two years before the Act was passed), *The Modern Corporation and Private Property* (1932)."[57] In that book Professor Berle and his coauthor Professor Gardiner C. Means, a statistical economist, restated the basics of fraud-on-the-market reliance, explaining that "if a corporation consciously overstated its income leading to a rise in the value of the shares, a buyer on the faith of such valuation should have no greater difficulty in recovering" than would an investor to whom false statements were directly made.[58]

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[56] *Id.* *See also* Robert A. Prentice, *Stoneridge, Securities Fraud Litigation, and the Supreme Court*, 45 Am. Bus. L.J. 611, 662-63 & nn.221-222 (2008); Norman S. Poser, *Stock Market Manipulation and Corporate Control Transactions*, 40 U. Miami L. Rev. 671, 697-700 (1986).

[57] *Sutter v. Groen*, 687 F.2d 197, 201 (7th Cir. 1982) (Posner, J., for the court, employing Professor Berle's book to interpret §10(b)) (italics added) (citing Aldoph A. Berle, Jr. & Gardiner C. Means, *The Modern Corporation and Private Property* (1932)). This Court too has cited and relied on the book. *See, e.g.*, *Wolf v. Weinstein*, 372 U.S. 633, 644 n.12 (1963); *Niagara Hudson Power Corp. v. Leventritt*, 340 U.S. 336, 346 n.7 (1964). Further examples of this Court's reliance on Professor Berle's scholarship include: *Simpson v. Union Oil Co.*, 377 U.S. 13, 22 n.9 (1964);*United States v. Phila. Nat'l Bank*, 374 U.S. 321, 324 n.2 (1963); *NLRB v. Deena Artware, Inc.*, 361 U.S. 398, 404 (1960); *Price v. Gurney*, 324 U.S. 100, 105 (1945); *Helvering v. Sw. Consol. Corp.*, 315 U.S. 194, 200 (1942).

[58] Berle & Means, *The Modern Corporation*, *supra* at 314 & n.1, 322.

Significantly, the presumption of reliance on the integrity of market price did not depend upon the Efficient Capital Market Hypothesis, which had yet to be framed. Neither did §9(e)'s provision that where market prices are affected by deceptive statements or actions, "[a]ny person who willfully participates . . . shall be liable to any person who shall purchase or sell any security at a price which was affected." 15 U.S.C. §78i(f).

The enactment of §10(b)'s proscription of "any manipulative or deceptive device or contrivance," 15 U.S.C. §78j(b), against this backdrop is significant. For the statute itself clearly embraces Professor Berle's understanding of securities markets and their manipulation.

Describing the "Necessity for regulation" in Exchange Act §2, Congress observed that market transactions establishing securities' prices may be subject to any variety of manipulative or deceptive practices, and declared that the Exchange Act is "to insure the maintenance of fair and honest markets."[59] Section 2(2) states that "[t]he prices established and offered in such transactions are generally disseminated and quoted throughout the United States," and that they "constitute a basis for determining and establishing the prices at which securities are bought and sold."[60] "Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control," Congress added in §2(3), warranting regulations requiring both the full disclosure of truthful information by securities issuers, and also a blanket proscription of fraud and manipulation affecting those prices.[61] Section 10(b) thus makes it unlawful "directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of

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59 15 U.S.C. §78b.

60 15 U.S.C. §78b(2).

61 15 U.S.C. §78b(3).

any security . . . any manipulative or deceptive device or contrivance" that contravenes SEC rules. 15 U.S.C. §78j(b).

The Exchange Act's legislative history confirms the understanding, expressed in §2. "The disclosure of information materially important to investors may not instantaneously be reflected in market value, but despite the intricacies of security values truth does find relatively quick acceptance on the market," said House Report No. 1383.[62] Congress clearly intended that investors should be entitled to rely on the integrity of prices thus established, even if information was not "instantaneously" reflected. *See id.*

"In drafting [the Exchange] Act," this Court held in *Basic*, "Congress expressly relied on the premise that securities markets are affected by information, and enacted legislation to facilitate an investor's reliance on the integrity of those markets."[63] This Court quoted from the House Report:

> "No investor, no speculator, can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings [sic] about a situation where the market price reflects as nearly as possible a just

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62 H.R. Rep. No. 1383, 73d Cong., 2d Sess., at 11 (1934), *reprinted in* 5 Ellenberger & Mahar, *Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934*, Item 18.

63 *Basic*, 485 U.S. at 245-46.

> price. Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value."[61]

Though *Basic* does not mention it, Congress also addressed the element of reliance with the Exchange Act's amendment inserting a new reliance requirement for certain claimants under §11 of the Securities Act of 1933 ("Securities Act"), expressly specifying that "such reliance may be established without proof of the reading of the registration statement."[65] The Conference Report explained that while it could be assumed that statements in offering documents initially determined a security's price, where an intervening 12 months of audited financial results have been released, proof of a lingering effect should be required.[66]

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64 *Id.* at 246 (quoting H.R. Rep. No. 1383, at 11).

65 Exchange Act §206(a), 48 Stat. 907, amending Securities Act §11(a), as *codified at* 15 U.S.C. §77k(a), states:

> If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection *shall be conditioned on proof that such person acquired the security relying upon such untrue statement* in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established *without proof of the reading of the registration statement by such person.*

15 U.S.C. §77k(a) (emphasis added).

66 The Conference Report explained:

> Section 11(a) is amended so as to require proof that the purchaser of a security at the time he

Thus, the 1934 Congress's focus clearly was on the integrity of market prices established on the basis of available material information, and on investors' presumptive reliance on the integrity of the price established. "An investor who buys or sells stock at the price set by the market," this Court concluded in *Basic*, "does so in reliance on the integrity of that price."[67] "Because *most* publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action."[68]

Yet Petitioners and their *amici* insist that *Basic* rests instead upon the Efficient Capital Market Hypothesis, which was framed and used by economists in the 1960s and after to test just *how quickly and completely* markets respond to new information. The researchers' answer:

> acquired the security, relied upon the untrue statement in the registration statement or upon the registration statement and did not know of the omission. But this requirement is imposed only in the case of purchase after a period of 12 months subsequent to the effective registration date and then only when the issuer shall have published an earning statement to its security holders covering a period of at least 12 months after the registration date. The basis of this provision is that in all likelihood the purchase and price of the security purchased after publication of such an earning statement will be predicated on that statement rather than upon the information disclosed upon registration.

H.R. Rep. No. 1838, 73d Cong. 2d Sess., at 41 (1934) (Conference Report), *reprinted in* 5 Ellenberger & Mahar, Item 20.

67 485 U.S. at 247.

68 *Id.* (emphasis added).

very quickly.[69] Citing efficient-markets research in *Basic*, this Court observed: "Recent empirical studies have tended to confirm Congress's premise that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations."[70]

From this, Petitioners and their *amici* conclude *Basic*'s presumption of reliance necessarily rests upon the universal validity of the hypothesis that *all* public information is *instantaneously* incorporated in market price. Yet even the efficient-markets literature recognized, from the outset, that its "hypothesis that securities prices at any point in time 'fully reflect' *all* available information," is quite "obviously an extreme null hypothesis," and that "like any other extreme null hypothesis, we do not expect it to be literally true."[71]

Petitioners and their *amici* insist that *Basic*'s holding nevertheless depended upon the hypothesis being strictly and literally true. *Basic* itself rejected that position. Having noted that the efficient-markets research "tended to confirm Congress's premise," the Court immediately added:

> We need not determine by adjudication what economists and social scientists have debated through the use of sophisticated statistical analysis and the ap-

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69 *See* Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. Fin. 383 (1970); Eugene Fama, *et al.*, *The Adjustment of Stock Market Prices to New Information*, 10 Int'l Econ. Rev. 1 (1969).

70 *Basic*, 485 U.S. at 246.

71 Fama, *Efficient Capital Markets*, 25 J. Fin. at 388 (emphasis in original); *see also* Eugene Fama, *Efficient Capital Markets: II*, 46 J. Fin. 1575, 1575 (1991).

> plication of economic theory. For purposes of accepting the presumption of reliance in this case, we need only believe that market professionals generally consider *most* publicly announced material statements about companies, thereby affecting stock market prices.

Basic, 485 U.S. at 247 n.24 (emphasis added). "By accepting this rebuttable presumption," this Court added, "we do not intend conclusively to adopt any particular theory of how quickly and completely publicly available information is reflected in market price." *Id.* at 249 n.28.

False statements, publicly disseminated, lie at the core of §10(b)'s proscription against "artificially affecting the price of securities." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). Market prices need only be "efficient" enough to think it likely that a misrepresentation will be picked up. There is no question that Amgen's stock is sufficiently efficient. The parties so stipulated.

Criticisms of the Efficient Capital Market Hypothesis fundamentally misunderstand *Basic's* holding, which is expressly grounded in the enacting Congress's understanding that securities markets tend to incorporate publicly available information. *See Basic*, 485 U.S. at 245-46. Based on that understanding (which efficient-markets research, despite some fairly minor anomalies, still strongly confirms) the Court held that investors are entitled to rely on securities markets' integrity. As material misstatements disseminated in an "open and developed" market typically affect a security's price, objective materiality circumstantially establishes investors' reliance. That *Basic* remanded for reconsideration of summary judgment on materiality, *id.* at 241, while *affirming* class certification entered without factual findings on materiality, clearly

indicates that statements' materiality and effect on the market present a common question for classwide resolution under Rule 23 rather than a predicate to certification.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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APPENDIX

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AMICUS CURIAE BRIEF

RECORD AND BRIEFS

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v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF FINANCIAL ECONOMISTS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICI*

Amici are academic financial economists whose scholarship and teaching focuses on public securities markets.[1] Sanjai Bhagat is the Provost Professor of Finance at the University of Colorado. Matthew Billett holds the Richard E. Jacobs Chair in Finance at Indiana University. Michael Bradley is the F. M. Kirby Professor of Investment Banking Emeritus and Professor of Law at Duke University. Marti G. Subrahmanyam is the Charles E. Merrill Professor of Finance and Economics at New York University.

SUMMARY OF THE ARGUMENT

This Court's decision in *Basic v. Levinson*, 485 U.S. 224 (1988), endorsed the "fraud-on-the-market" theory, under which courts may presume that securities prices in an open and developed market reflect all material public information and that investors rely on the integrity of the market price. Together, these two presumptions allow plaintiff investors to establish that they have relied, indirectly, on allegedly false or misleading public statements of corporate managers. The fraud-on-the-market presumptions assume a critical role in securities class actions under Fed. R. Civ. P. 23, because they render the element of reliance a common issue once plaintiffs establish that the market for the relevant security is efficient.

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1. Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part, and that no person other than *amici* and their counsel made a monetary contribution to the preparation or submission of this brief. The parties have filed letters giving blanket consent to the filing of *amicus* briefs in this case.

Like this Court's decision last term in *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011), this case involves an effort to require plaintiffs to prove the merits of their case at class certification. In *Halliburton*, this Court unanimously rejected the Fifth Circuit's requirement that plaintiffs prove loss causation—an element of their claims on the merits—as a necessary prerequisite to applying *Basic*'s presumptions and certifying a class. *See id.* at 2186. Similarly, in this case, Petitioners argue that a different element of plaintiffs' merits case—the materiality of the defendants' misrepresentations—must be proven at the class-certification stage as a prerequisite to invoking *Basic*'s presumptions.

Also as in *Halliburton*, Petitioners support their effort to alter the *Basic* framework by questioning the economic premises on which the *Basic* presumptions rest. As the *Basic* Court acknowledged, the fraud-on-the-market theory rested on an economic premise—well supported in the economic literature and accepted by Congress—"that the market price of shares traded on well-developed markets reflects all publicly available information." 485 U.S. at 246. This underlying theory is the "efficient markets hypothesis," and it is one of the most widely accepted theories in the social sciences.

The principal purpose of this brief is to address the criticism of the efficient markets hypothesis by Petitioners and their *amici*. We make three central points: First, the version of the efficient markets hypothesis that this Court relied upon in *Basic*—what financial economists today refer to more precisely as the "semi-strong" version of the efficient market hypothesis ("SSEMH")—remains widely

accepted as a fundamental principle of modern financial economic theory. That is true even though—like *all* useful social science theories applicable to human behavior—it is not perfect and does not explain every conceivable price movement for every market-traded economic asset. While recent work has identified anomalies in market behavior that are of interest to theoretical economists, those anomalies (to the extent they actually exist) are too small to undermine the SSEMH's usefulness for the purposes that this Court employed it in *Basic*.

The second point concerns the uses and limitations of particular forms of economic proof. Under *Basic*, plaintiffs must demonstrate that the market for the security at issue in a class action is sufficiently efficient to warrant application of the *Basic* presumptions, and the lower courts have generally analyzed this issue under a multi-factor test developed in two district court decisions, *Cammer v. Bloom*, 711 F. Supp. 1263 (D.N.J. 1989), and *Krogman v. Sterritt*, 202 F.R.D. 467 (N.D. Tex. 2001). *Amici* believe, contrary to the suggestion of some of Petitioners' *amici*, that these factors are both economically appropriate and manageable for trial courts. In particular, trial courts can and do rely on the most direct test of market efficiency—an "event study" that demonstrates cause and effect relationships between new information and contemporaneous changes in market price. The critical point, however, is that while event studies can effectively demonstrate whether a particular security trades in an efficient market, such studies are generally not sufficiently fine-grained to determine whether particular statements alleged to be fraudulent moved the market for a security. Accordingly, the sort of economic analysis that Petitioners and their *amici* would demand to establish materiality

at the class certification stage—in contrast to the well-established analyses currently applied to show market efficiency for a security generally—would be unworkable in most circumstances.

Third, the showing that Petitioners and their *amici* demand is not only unworkable in practice, but also inappropriate in principle. However materiality is shown, materiality is a quality of the defendants' statements or omissions—not of the individual plaintiffs' response to those statements or omissions. In other words, materiality is a common question to all class members, and therefore irrelevant to the showing that *Basic* requires. The economic proof that Petitioners demand will be unitary for all members of the plaintiff class; moreover, it will be identical to any showing required of plaintiffs on the merits. Moreover, the economic arguments Petitioners offer to challenge the SSEMH—e.g., that markets do not process all forms of information in the same way or at identical speeds—do not go to the legal question of materiality defined by this Court.

Finally, *amici* also note that the SSEMH was not simply a theory that the Court found helpful in *Basic*, but was actually central to this Court's interpretation of *Congress*'s intent. If economic revisionism is to drive a departure from *Basic*'s formula, that decision should be made by Congress rather than by this Court.

ARGUMENT

I. The Efficient Markets Hypothesis Remains a Sound and Well-Accepted Basis for the Fraud-on-the-Market Presumption of Reliance in Securities Class Actions.

A. The meaning of an "efficient market."

Courts and commentators have recognized that stock markets respond to and reflect material information—including false information—for at least two centuries.[2] Eugene Fama's seminal work in this area distinguished among three different types of market efficiency:

> "Weak-form" efficiency means that historical prices are not predictive of future prices. Excess profits cannot be earned using strategies based on historical prices.

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2. *See, e.g., Rex v. De Berenger*, 3 M.&S. 67, 105 Eng. Rep. 536 (K.B. 1814); *see also* Barbara Black, *Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C. L. Rev. 35, 456 (1984). William O. Douglas, who was intimately involved in drafting the Securities Act, articulated this understanding in 1934:

> [E]ven though an investor has neither the time, money, nor intelligence to assimilate the mass of information in the registration statement, there will be those who can and who will do so, whenever there is a broad market. The judgment of those experts will be reflected in the market price.

William O. Douglas, *Protecting the Investor*, 23 Yale L. Rev. 522, 524 (1934).

> "Semi-strong form" efficiency implies that all public information is reflected in a stock's current market price, and that security prices adjust to new publicly available information so that it is impossible to earn excess returns by trading on that information.
>
> "Strong-form" efficiency implies that all information in the market, whether public or private, is accounted for in the market price. Investors cannot consistently earn excess profits over a long period of time—even if they have inside information.[3]

Although all three models are sometimes described as variations of the efficient markets hypothesis, references to that hypothesis in the context of describing how financial markets actually operate typically refer to the "semi-strong" version (SSEMH).[4] Critically, the SSEMH

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3. *See* Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. Fin. 383 (1970). *See also Schleicher v. Wendt*, 618 F.3d 679, 685 (7th Cir. 2010) (Easterbrook, J.) (explaining the difference between these three forms of market efficiency).

4. *See* Eugene Fama, *Efficient Capital Markets: II*, 46 J. Fin. 1575, 1575 (1991) ("I take the market efficiency hypothesis to be the simple statement that security prices fully reflect all available information .... A weaker and economically sensible version of the efficiency hypothesis says that prices reflect information to the point where the marginal benefits of acting on the information (the profits to be made) do not exceed the marginal cost."). Standard finance textbooks provide similar definitions. *See, e.g.*, Richard Brealey, Stewart Myers & Franklin Allen, *Principles of Corporate Finance* 317-18 (10th ed. 2011); Stephen A. Ross, Randolph W. Westerfield & Jeffrey Jaffe, *Corporate Finance* 430-31 (9th ed. 2010).

is the version upon which *Basic*'s presumption rests. The presumption's point, after all, is that the market can be "fooled" by public, material misrepresentations, such that false information is reflected in the market price for the company's securities. Under the broadly rejected theory of "strong form" efficiency, no deception would be possible because *all* true information, including truths known only privately, would be reflected in market prices.[5]

The SSEMH is a theory of *informational* efficiency and must be distinguished from theories of *fundamental* efficiency. Informational efficiency posits that stock prices will reflect publicly available information quickly and in a generally unbiased manner. In contrast, "fundamental efficiency" posits that stock prices accurately reflect the true value of a company. Virtually no financial economists believe that securities markets are fundamentally efficient.[6] But *Basic*'s presumption of reliance rested only on informational efficiency—that is, the notion that "in an open and developed securities market, the price of a company's stock is determined by the *available material information* regarding the company and its business." 485

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5. *See Schleicher*, 618 F.3d at 685 ("Many economists think that the strong form of the hypothesis has been refuted, but the weak and semi-strong forms are widely accepted. And the fraud-on-the-market doctrine rests on the semi-strong form."); *see also* Daniel Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 Cornell L. Rev. 907, 910-11 (1989).

6. *See, e.g.*, Andrei Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance* 5, 24 (2000) (noting "overwhelming" empirical evidence of informational efficiency, while observing that "[fundamental] efficiency only emerges as an extreme special case, unlikely to hold under plausible circumstances").

U.S. at 247 (emphasis added).[7] "For purposes of accepting the presumption of reliance," the Court explained, "we need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices." *Id.* at 247 n.24.

For purposes of class certification and the fraud-on-the-market doctrine, the critical aspect of the SSEMH is an efficient market's ability to incorporate public information in the security price. The SSEMH holds that market prices respond promptly to new material information.[8] Modern financial markets are "amazingly successful devices for reflecting new information rapidly. The response time may not be immediate; sometimes there is underreaction for a short period. But by and large, prices reasonably reflect whatever public knowledge

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7. Justice White's dissent, which criticized the majority for "implicitly suggesting that stocks have some 'true value'," 485 U.S. at 255 (White, J., dissenting), thus misconstrued the majority's reasoning. *See* Ian Ayres, *Back to Basics: Regulating How Corporations Speak to the Market*, 77 Va. L. Rev. 945, 983 (1991) (noting that the dissent in *Basic* misconstrued the concept of efficiency on which the majority relied). The Court equated market price with "true value" only in the limited sense that a market price, reflecting public information, is the best available estimate of value. 485 U.S. at 244 (majority opinion).

8. *See, e.g.*, Donald Langevoort, *Theories, Assumptions and Securities Regulation: Market Efficiency Revisited*, 140 U. Pa. L. Rev. 851, 851 (1992) (describing the theory's "central insight ... that a variety of forces impound available information into stock prices fast enough that arbitrage opportunities cannot be exploited systematically").

there is about each [publicly traded] company."[9] In such a market, class members may be presumed to have relied on the integrity of the market price without regard to whether they individually relied on a particular statement, because that statement is itself incorporated into the price.

The vast majority of finance academics believe that U.S. markets for public securities are informationally efficient.[10] Of course, professional investment advisors (who have an interest in persuading others to believe that they can consistently outperform the market) and members of the financial press periodically proclaim that the efficient market hypothesis has "failed"—citing most recently its failure to avert the 2008 stock market crash.[11] As Professor Malkiel recently explained, however, "such

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9. Burton G. Malkiel, *A Random Walk Down Wall Street* 269 (10th ed. 2011); *see also* Ronald Gilson & Bernard Black, *The Law and Finance of Corporate Acquisitions* 146-57 (2d ed. 1995) (concluding that a variety of mechanisms ensure the informational efficiency of modern financial markets).

10. *See, e.g.*, Esther Bruegger & Frederick Dunbar, *Estimating Financial Fraud Damages with Response Coefficients*, 35 J. Corp. L. 11, 46 (2009) ("[M]ost academic studies accept the hypothesis that capital markets are efficient."); Ivo Welch, *Views of Financial Economists on the Equity Premium and on Professional Controversies*, 73 J. Bus. 501, 537 (2000) (finding that more than 79% of finance academics agreed with the proposition that "by and large, public securities market prices are efficient").

11. *But cf.* Stephen Brown, *The Efficient Markets Hypothesis: The Demise of the Demon of Chance?* 51 Accounting & Fin. 79, 82 (2011) (noting popular confusion as to what SSEMH really means, and pointing out that SSEMH actually implies that market participants will be unable to foresee the collapse of bubbles).

obituaries are greatly exaggerated," and both academic research and experience "resoundingly confirm[]" the validity of the SSEMH. Malkiel, *Random Walk*, at 268-69.[12]

B. Variations in the efficiency with which generally efficient markets process particular kinds of information are not sufficiently significant to undermine *Basic*'s presumption.

In the real world, of course, financial markets do not exhibit *perfect* efficiency. If markets perfectly reflected all public information in the stock price, there would be no incentive for any investor to analyze that information when making investment decisions—and then there would be no mechanism for such information to be reflected in stock prices. Even semi-strong form efficient markets must provide sophisticated investors an incentive to analyze public information.[13] But such markets are more than sufficiently efficient to support *Basic*'s fraud-on-the-market presumption.

Efforts to test or criticize the SSEMH focus on whether investors can "earn above-average returns

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12. *See also* Ray Ball, *The Global Financial Crisis and the Efficient Market Hypothesis: What Have We Learned?* 21 J. Applied Corp. Fin. 8, 10 (2009); Daniel Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 Cornell L. Rev. 907, 915-17 (1989).

13. *See* Sanford Grossman & Joseph Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70 Am. Econ. Rev. 393, 404-05 (1980).

without accepting above-average risks."[14] If investors who closely analyze the market cannot consistently earn above-average returns based on public information, this is a signal that the market price has already incorporated such information. Hence, empirical efforts to test the SSEMH focus on efforts to generate above-average returns by trading strategies based on public information. Numerous papers have purported to document findings inconsistent with the SSEMH ever since Professor Fama's pathbreaking article in 1970. But anomalies identified by these critiques tend "to disappear, reverse, or attenuate"—either because they are quickly arbitraged away or because they were simply statistical aberrations in the first place.[15] And efforts to achieve above-average returns through investment strategies based on these critiques have been well-documented failures.[16]

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14. Burton G. Malkiel, *The Efficient Market Hypothesis and its Critics*, 17 J. Econ. Perspectives 59, 60 (2003). Some of the critiques cited by Petitioners' *amici* criticize the efficient markets hypothesis but fail to demonstrate that the anomalies they identify can be exploited to generate abnormal returns. *See, e.g.*, William O. Fisher, *Does the Efficient Market Theory Help Us Do Justice in a Time of Madness?* 54 Emory L. J. 843 (2005). Without such a demonstration, there is simply no empirical confirmation that those critiques are of sufficient magnitude to undermine *Basic*'s presumption.

15. William Schwert, *Anomalies and Market Efficiency*, in *Handbook of Economics and Finance* 940 (2003); *see also* Malkiel, *Random Walk*, at 274 (observing that "many of these predictable patterns may simply be the results of data mining" and that "[g]iven enough time and massaging of data series, it is possible to tease almost any pattern out of most data sets").

16. *See* Malkiel, *Random Walk*, at 267-300; Ball, 21 J. Applied Corp. Fin. at 15 (noting that funds established to take advantage of behavioral economics strategies have failed to outperform the market). Professors Fang, Jacobsen and Qin provide evidence

Recent critics of the SSEMH have cited work by behavioral economists, who have suggested that short-run momentum in market movements may be caused by certain psychological feedback mechanisms, such as "bandwagon effects." These effects, however, are too small to undermine the basic point of the SSEMH. Empirical work has demonstrated that an investment strategy predicated on the SSEMH would do much better than a momentum-based strategy, even in periods where some degree of momentum exists.[17] In any event, the behavioral literature involves such extremely small pricing variances that it could have, at most, only a *de minimis* impact on SSEMH.[18]

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that several well-known technical trading strategies perform quite poorly in out-of-sample tests. *See* Jiali Fang, Ben Jacobsen, & Yafeng Qin, *Predictability of the Simple Technical Trading Rules: An Out-of-Sample Test* (June 13, 2012), available at http://ssrn.com/abstract=2066182.

17. *See* Malkiel, *Random Walk*, at 276.

18. *See* Malkiel, 17 J. Econ. Perspectives at 61-62. A recent analysis of the finance literature concludes that "BF (Behavioral Finance) lags behind EMH (Efficient Market Hypothesis) in terms of the quantity, dynamics, scope, and international reach of citations. BF is far from stealing a march on the EMH, and the latter is still used as the benchmark." Dariusz Wojcik, Nicholas Kreston, & Sarah McGill, *Freshwater, Saltwater, and Deepwater: Efficient Market Hypothesis versus Behavioral Finance*, Oxford University School of Geography and the Environment Working Paper No. 12-03 (February 21, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2008788; *see also* Xi Li & Rodney Sullivan, *The Limits to Arbitrage Revisited: The Accrual and Asset Growth Anomalies*, 67 Fin. Analysts J. 50 (July/August 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1907313 (documenting that highly publicized accrual and asset growth anomalies are an artifact of inadequate risk adjustment).

To undermine *Basic*'s fraud-on-the-market doctrine, these critiques would have to show anomalies far greater in magnitude than any demonstrated to date. Even the anomalies for which the evidence is strongest have not proven large enough that a trading strategy based on them can generate above-average returns.[19] The question under *Basic* is simply whether the market for a security is efficient in the sense that a court may reasonably presume that materially false or misleading new information about a company affects the stock price in some manner. Nothing in *Basic* turns on the magnitude of the effect. Rather, the question is simply whether information affects the stock to some extent, so that the price a purchaser or seller pays or collects can be said to reflect, to some degree, the impact of that information on the market.

Similarly, economic evidence that markets may process different sorts of information at different rates does not undermine *Basic*'s presumption. The critical question is not the speed of adjustment, but rather whether a market generally reacts to material information, such that a material misstatement or omission would distort the market price.[20] Arguments about the *timing* of market adjustment might affect the damages to which particular plaintiffs are entitled, but such concerns generally have not been considered a barrier to class certification.[21]

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19. *See* note 16, *supra*.

20. *See* Donald C. Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 Wisc. L. Rev. 151, 169-70.

21. *See, e.g., Blackie v. Barrack*, 524 F.2d 891, 909 (9th Cir. 1975); 6 Alba Conte & Herbert B. Newberg, *Newberg on Class Actions* § 18:27 (4th ed. 2002) ("A particularly significant aspect of the Rule 23(b)(3) approach is the recognition that individual damages questions do not preclude a Rule 23(b)(3) class action when the issue of liability is common to the class.").

The SSEMH has been subjected to "perhaps the most intensive and extensive testing of any hypothesis in all of the social sciences"—and this extraordinary scrutiny has confirmed the strong empirical support for this theory.[22] Although SSEMH is not entirely free of anomalies, those anomalies are sufficiently limited that, as a practical matter, the idea that prices efficiently incorporate information is an indispensable foundation for how we organize the real world.[23] Critically, *amici* are unaware of any research (let alone empirically tested theory) suggesting that any of the purported anomalies might be so strong—or the concepts underpinning SSEMH so weak—that the market price for a publicly traded security in the U.S. would *not* be distorted by materially false or misleading public statements by the company's managers.

II. Courts Are Able to Evaluate the Efficiency of Markets for Particular Securities under Current Law.

Petitioners and their *amici* have suggested that courts are *unable* to adequately determine whether markets for particular securities are efficient, but that courts *can* determine materiality by economic studies assessing the market impact of the alleged misrepresentations at issue. Both suggestions fundamentally misunderstand what economic proof can and cannot accomplish.

In conducting a general assessment of a market's efficiency, lower courts have successfully employed a multi-factor analysis developed in *Cammer v. Bloom*, 711

22. Sanjai Bhagat & Roberta Romano, *Empirical Studies of Corporate Law*, in 2 *Handbook of Law and Economics* 948 n.1 (Polinsky & Shavell, eds. 2007).

23. Ball, 21 J. Applied Corp. Fin. at 15.

F. Supp. 1263 (D.N.J. 1989), and *Krogman v. Sterritt*, 202 F.R.D. 467 (N.D. Tex. 2001). That analysis is not perfect, but it is workable—particularly when courts emphasize economic event studies demonstrating that market prices move in response to new information.

In contrast, event studies and similar economic tools have a much harder time assessing the market impact of particular statements or omissions (including those that may form the basis of a securities fraud suit). *Amici* thus disagree with suggestions by Petitioners and their *amici* that courts should demand this sort of proof to establish materiality, much less as a predicate for class certification. We submit, moreover, that demanding such proof would amount to a frontal assault on *Basic*, which did not demand any such showing.

A. Event studies work well to determine whether a stock trades in an efficient market.

Cammer and *Krogman* identify eight widely adopted factors to assess market efficiency: (1) average weekly trading volume; (2) analyst coverage; (3) number of market makers; (4) SEC Form S-3 eligibility; (5) price reaction to unexpected information (*e.g.*, an "event study"); (6) market capitalization; (7) bid-ask spreads; and (8) percentage of shares held by non-insiders (the public "float"). *See Cammer*, 711 F. Supp. at 1285-87; *Krogman*, 202 F.R.D. at 477-78. The financial economics literature does not identify any single test or method for classifying a particular market as "efficient" or "inefficient," and some of these factors are more helpful than others from an economic perspective. In particular, *amici* believe courts should primarily rely on an event study as the best evidence of market efficiency, with the other factors used as a supplement when event study results are inconclusive.

Cammer correctly noted that "one of the most convincing ways to demonstrate [market] efficiency would be to illustrate, over time, a cause and effect relationship between company disclosures and resulting movements in stock price." 711 F. Supp. at 1291. The customary method for establishing such a connection is an "event study," which uses well-accepted statistical methods to isolate the impact of information on market prices.[24] Event studies are not a direct test of market efficiency, but they have been used for over 30 years to identify markets in which efficiency may be inferred. Such studies have formed the basis for hundreds of academic articles.[25]

An event study begins by specifying a model of what price movements are "expected" based on market factors and then testing whether the deviation from expected price movements is sufficiently large that simple random movement can be rejected as the cause. Thus, a widely accepted method involves preparing a regression model over an appropriate period that quantifies the relationship between the market price of the relevant security and broad general market (and industry) factors, using actual historical prices and index data. By comparing the dates on which statistically significant abnormal returns were

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24. David Tabak & Frederick Dunbar, *Materiality and Magnitude: Event Studies in the Courtroom*, in *Litigation Services Handbook, The Role of the Financial Expert*, Ch. 19 (3d ed. 2001).

25. *See* Sanjai Bhagat & Roberta Romano, *Event Studies and the Law, Part I*, 4 Am. L. & Econ. Rev. 141, 142 (2002) ("The event study methodology is well accepted and extensively used in finance.... Its use in policy analysis in recent years has become more widespread."); John Binder, *The Event Study Methodology Since 1969*, 11 Rev. Quant. Fin. & Acc'ting 111, 111-137 (1998).

observed to the information that was publicly disclosed during (or immediately preceding) the time period when the market was open for trading on those dates, an empirically valid assessment can be made of the extent to which *new* material information, rather than random chance, is responsible for changes in the price of the security.[26]

The feasibility of event studies as a general empirical test of market efficiency means that courts will only infrequently need to resort to the other *Cammer/Krogman* factors to assess whether a market exhibits the basic hallmarks of informational efficiency. Nonetheless, if the basic event study is inconclusive, the other *Cammer/Krogman* factors provide useful additional evidence from which the presence (or absence) of semi-strong form efficiency may be inferred. Moreover, these factors tend to weed out markets most likely to be affected by the kinds of anomalies (to the extent they actually exist) identified by critics of the efficient market hypothesis.[27]

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26. *See* Bruegger & Dunbar, 35 J. Corp. L. at 33 (noting that event studies only detect impact of unexpected information, given that securities prices are not expected to react to information the market already anticipates). For useful discussions of event study methodology, *see, e.g.* Bhagat & Romano, 2 *Handbook of Law and Economics* at 945; Frank Torchio, *Proper Event Study Analysis in Securities Litigation*, 35 J. Corp. L. 159, 163-64 (2009).

27. *See, e.g.*, Nicholas Barberis & Richard Thaler, *A Survey of Behavioral Finance*, in 1B *Handbook of the Economics of Finance* 1112 (George M. Constantinides, et al., eds., 2003) (noting that the active presence of arbitrageurs reduces anomalies and promotes informational efficiency); Ronald J. Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias*, 28 Iowa J. Corp. L. 715, 734-36 (2003)

For example, average weekly trading volume can be linked to information dissemination to the market because volume helps investment analysts decide which stocks to follow[28] and is thus a useful indicator of efficiency. Likewise, extensive analyst coverage implies strong interest in information about a company's securities,[29] although the post-*Cammer* explosion of alternative methods by which information is disseminated to investors has made traditional analyst coverage less central. And a security issuer's eligibility to file SEC Form S-3[30] is also a good confirmatory indicator, as it demonstrates the SEC's own "belief that the market operates efficiently for these companies, *i.e.* that the disclosure in [prior filings] and other communications by the registrant, such as press releases, has already been disseminated and accounted for by the marketplace." *Cammer*, 711 F. Supp. at 1284 (quoting Exchange Act Release No. 6331 46 Fed. Reg. at 41,904). Finally, the prevalence of non-insider holders, particularly large institutional holders, of a security is likely a valid indicator of, though not a prerequisite for, market efficiency.

(observing that many anomalies disappear when economists study larger issuers).

28. *See* Randall Thomas & James Cotter, *Measuring Securities Market Efficiency in the Regulatory Setting*, 63 L. & Contemp. Probs. 105, 108 (2000).

29. *See* Brad Barber, Paul Griffin & Baruch Lev, *The Fraud on the Market Theory and Indicators of Common Stock's Efficiency*, 19 Iowa J. Corp. Law 285, 302 (1994).

30. SEC Form S-3 allows certain public companies that have met federal reporting requirements for more than one year to incorporate prior SEC filings by reference without repeating the information. See www.sec.gov/about/forms/forms-3.pdf.

Critiques of the *Cammer/Krogman* approach to judging market efficiency thus have the same limitation as the critiques of the efficient market hypothesis discussed in Part I: They may suggest limitations of the analysis as a matter of economic theory, but the *Cammer/Krogman* factors remain useful in the context that courts actually employ them. As Professors Cornell and Rutten explain, "[t]he dispositive question for reliance is not whether the market is truly efficient, *but whether it is efficient enough that reasonable investors can be presumed to have relied on the market price.*" Bradford Cornell & James Rutten, *Market Efficiency, Crashes, and Securities Litigation*, 81 Tul. L. Rev. 443, 456 (2006) (emphasis added). They thus correctly conclude that "[t]here is ... little dispute that with respect to such securities, reliance on the integrity of market prices (and thus on the defendants' statements) is appropriately presumed." *Id.* at 457. In other words, "[f]rom an economic perspective, the courts in *Cammer* and *Krogman* got it right." *Id.* at 456.

B. Event studies do *not* work well in determining whether particular statements alleged to be fraudulent moved the market for a security, and in most cases would also functionally duplicate the class certification test that this Court rejected in *Halliburton*.

Petitioners have argued that measures of overall market efficiency do not guarantee that the market will process all types of information efficiently, and they suggest that plaintiffs be required to prove not only that "the misrepresentation at issue [was] material," but also that "the market [was] efficient as to that misrepresentation" as prerequisites to class certification. Petitioners' Brief

at 34. Likewise, Petitioners' *amici* have suggested that "[i]n determining reliance, courts should look to market movement caused by an alleged misrepresentation, rather than to overall market efficiency," and that this inquiry could be done by event studies. *See* Brief of Law Professors as *Amici Curiae* in Support of Petitioners, at 26-27. The trouble with these suggestions, as an economic matter, is that event studies are considerably more effective in determining the overall efficiency of the market in which a particular security trades than they are at evaluating the market impact of particular statements that may form the basis of litigation.

The strongest event studies look at the performance of a stock over a significant period of time and evaluate the impact on the stock price of multiple information releases over the course of that period. Although event studies sometimes evaluate the overall efficiency of the market for a particular security by looking at the impact of a single information release, such a study will get much more reliable results if the release to be evaluated can be chosen with the purpose of empirical testing in mind. If that is possible, researchers can choose a release that is isolated, rather than compounded with other news about the company or broader developments that affect the performance of the market as a whole. In these circumstances, event studies are a reliable guide to efficiency of the market in which a stock trades.

What Petitioners and their *amici* propose, however, would require event studies focused on the particular statements or omissions that plaintiffs claim to be fraudulent. This sort of study is problematic for a number of reasons. First, stocks rarely rise when the false statement

initially occurs, because many if not most securities cases involve either fraudulent omissions or false statements that are designed to conceal problems that defendants do not wish to disclose.[31] The company's statements may thus falsely confirm the market's expectations—thereby producing no rise in price but preventing a price *decline* that would have occurred had the company revealed the truth.[32] Similarly, sometimes firms will reveal *some* losses but fraudulently minimize the damage by making materially incomplete disclosures. *See Schleicher*, 618 F.3d at 683-84. In all these common scenarios, there is no practicable way to measure the "front-end" price impact of the initial false statement or omission; instead, economists will seek to infer price impact from the later drop in stock price after the truth comes out.[33]

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31. *See, e.g.*, Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 Ariz. L. Rev. 639, 654 (1996) (observing that "most open-market frauds" involve attempts to cover up "adverse business developments"); Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. Ill. L. Rev. 691, 726 (collecting empirical evidence and concluding that "concealing adverse business developments was the most common source of fraud charges, followed by concealing self-dealing and illegal acts").

32. *See, e.g.*, Frank Torchio, *Proper Event Study Analysis in Securities Litigation*, 35 J. Corp L. 159, 164 (2009) ("[S]ignificant stock price reactions are not expected in an efficient market when alleged misstatements merely confirm the market's prior expectations."); Bhagat & Romano, 4 Am. L. & Econ. Rev. at 143 (noting that under the SSEMH "only an unanticipated event can change the price of a stock").

33. *See* David Tabak, *Loss Causation and Damages in Shareholder Class Actions: When It Takes Two Steps to Tango*,

As a practical matter, the test Petitioners and their *amici* propose would most often rely on identifying a price drop upon the release of negative information that exposes the truth. In that scenario, price impact and loss causation become one and the same—and this case becomes functionally identical to *Halliburton*. Last term, this Court rejected the Fifth Circuit's requirement that plaintiffs prove loss causation as a predicate to class certification. *Halliburton*, 131 S. Ct. at 2185-86. The Court explained that "[t]he fact that a subsequent loss may have been caused by factors other than the revelation of a misrepresentation has nothing to do with whether an investor relied on the misrepresentation in the first place, either directly or presumptively through the fraud-on-the-market theory." *Id.* at 2186. Hence, "[l]oss causation has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory." *Id.*

Similarly to *Halliburton*, this case finds Petitioners conflating materiality and a price impact upon disclosure

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NERA Working Paper, May 2004 (available at http://www.nera.com/extImage/200405Tabak_Loss_Causation.pdf) ("[O]ne would not expect the stock price to move when defendants did not make a statement, so there is no reason to examine the stock price at the time of an alleged omission. An alternative way of showing the effect of the omission is by examining the stock price when the information was finally disclosed."); Torchio, 35 J. Corp. L. at 164 (noting that "it is incorrect and improper to use an event study to analyze or quantify the effect of information that was alleged to have been omitted," and stating that "an omission would be considered material to investors if a subsequent correct and complete statement caused a significant stock price reaction").

of fraud-related truth.[34] Significantly, neither Petitioners nor their *amici* even assert that their proposal would, in fraudulent omission or concealment cases, require anything other than the showing that *Halliburton* rejected. As an economic matter, the price impact that Petitioners seek to require will be functionally identical to loss causation in the majority of actual cases. The two concepts are properly distinct when a plaintiff's case rests upon an affirmative misrepresentation of new information by a company—perhaps an announcement of an attractive new product, unanticipated by the market, that the company knows it lacks the technology to actually produce. In such a scenario, one could measure the increase in the stock's price after the positive (but fraudulent) announcement. Loss causation, on the other hand, would assess the drop in price after the truth was revealed. But because most securities fraud cases turn on omissions or misstatements that confirm existing expectations, rather than on affirmative statements announcing positive information that is both new and unexpected, economists must infer the *ex ante* price impact from the *ex post* loss, *see supra* n. 32—which would result in exactly the same mini-trial on loss causation that *Halliburton* rejected. As the Court

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34. In *Halliburton*, this Court rejected Halliburton's effort to characterize the Fifth Circuit's rule as requiring proof not of loss causation but of "price impact," meaning "the effect of a misrepresentation on a stock price." *Id.* at 2187. As the Court rightly explained, "loss causation is a familiar and distinct concept in securities law; it is not price impact." *Id.* Our point here is simply that where initial price impact is *inferred* from loss causation, because there is no initial price increase from the defendant's fraudulent omission (or false reaffirmation of the market's expectations), *Halliburton*'s reasoning demands rejection of a price impact requirement as well.

stated there, all the reasons that loss causation remains a distinct requirement from reliance—for instance, that a subsequent price drop "could instead be the result of other intervening causes" than the defendant's fraudulent statement, even if plaintiffs relied on that statement, 131 S. Ct. at 2186—are reasons not to require proof of loss causation prior to class certification. And because price impact will generally rely on the same economic proof as loss causation, this Court should reject a price impact requirement as well.

A second problem with using event studies to prove price impact arises when the particular statements at issue take an idiosyncratic form. Although Petitioners have suggested that "a market can be efficient ... as to some types or sources of information but not others," Petitioners' Brief at 32, it is not practicable to test the efficiency of a market as to each and every potentially identifiable category of information. The Fifth Circuit's decision in *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007), for example, involved a claim that a telecommunications company had misstated the number of new lines it had installed during the first three quarters of 2001. Later, when Allegiance restated its line counts downwards, its stock dropped. The Fifth Circuit refused to apply *Basic*'s presumption that the false statements had impacted stock prices initially because it doubted that information about "line counts" was, in general, something the market absorbed. *Id.* at 269. But it would have been exceptionally difficult for plaintiffs to establish how line-count data is perceived by markets as a category of information, because economists would likely lack sufficient information to create an appropriate model and evaluate the impact of telecommunications line counts *per se* on securities markets.

A third problem is that a defendant's potentially fraudulent statements, as well as their disclosures of fraud-related truth, will often be compounded with other, simultaneous releases of information about the company or developments that affect securities prices generally. In such circumstances, event studies do not provide good mechanisms for separating out the impact of relevant information.[35] As a result, courts lack adequate economic tools to determine whether the market "is efficient as to a particular misrepresentation," Petitioner's Brief at 34, much less the extent of "market movement caused by an alleged misrepresentation," Petitioners' Law Professors' Brief at 27.

Requiring securities plaintiffs to demonstrate the market impact of particular statements would also create strong incentives for companies to release information in such a way as to make such demonstrations difficult. Companies exercise a large degree of discretion and control over the timing of information releases. If Rule 10b-5 plaintiffs were required to show a measurable market impact from any alleged misrepresentation, which—as above—would typically come from market reaction to disclosures of fraud-related truth, companies forced to make such disclosures could easily muddy the waters by releasing other news about the company. As Professor Fisch observes,

> Faced with the need to reveal their fraud, defendants can deliberately introduce additional

35. *See, e.g.*, Langevoort, 2009 Wisc. L. Rev. at 187 ("When [event studies] do not [produce determinate results], it is often not because there was no observable effect, but because there were too many possible causes.").

> causal factors. For example, before disclosing a fraud, corporate officials may release "unrelated" negative information that preemptively reduces stock price. This behavior is sometimes described as "walking down the stock price." Defendants may also bundle a corrective disclosure with good news that offsets the effect of the negative information on stock price. Still another alternative is to delay a corrective disclosure until immediately after market or industry bad news has caused stock prices to fall.[36]

That sort of obfuscation would only compound the already-significant difficulties inherent in pinpointing the economic impact of allegedly fraudulent statements.

It is true that plaintiffs will eventually have to prove such impact at trial on the merits. But it is more realistic to expect such proof after the completion of discovery. Discovery will often help, for example, in determining

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36. Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 Iowa L. Rev. 811 (2009); *see also* Langevoort, 2009 Wisc. L. Rev. at 187 (noting, in the context of a regime requiring plaintiffs to prove loss causation at class certification, that "the optimal strategy for a company is always to release corrective disclosure as part of a larger package, including more lies if necessary"). Evidence in the finance literature confirms that corporate managers do sometimes intentionally release several unrelated information items related to the company's financial prospects on the same day so as to obfuscate the impact of a particular announcement they are concerned about. *See* Sanjai Bhagat, David Hirshleifer, Ming Dong, & Robert Noah, *Do Tender Offers Create Value? New Methods and Evidence*, 76 J. Fin. Econ. 3 (2005).

which items of news about a company are related to the initial fraud. In *Oscar*, for example, the defendant telecommunications company not only restated its line counts downward, but simultaneously disclosed unexpectedly low earnings and other unfavorable financial information. *See* 487 F.3d at 264. While an event study would have struggled to distinguish the price impact of these different disclosures, discovery might well have revealed that the untruthful "line counts" announcement was in fact related to the simultaneous disappointing earnings announcement because the number of lines that a telecommunications company has presumably influences its earnings, and a lower count might decrease earnings. In that case, an event study should not treat the two announcements as unrelated.

Moreover, the company's internal assessments of its performance and the relative importance of particular developments and news may well assist the finder of fact in teasing out both the impact of particular statements and the extent to which distinct developments are in fact related. Discovery might reveal, for example, if the company intentionally chose to reveal unrelated "bad" news simultaneously with a corrective disclosure in order to mask the disclosure's effect—which could well be highly relevant to the factfinder's assessment of whether the stock price reaction was related to the fraud. Discovery might also reveal if the defendants falsely attributed fraud-related bad news to other, unrelated factors. It is thus critical to ensure that, when plaintiffs are ultimately asked to establish the impact of allegedly fraudulent statements, they have the benefit of a fully-developed factual record.

III. Plaintiffs Should Not Be Required to Prove that Particular Statements Are Material, Much Less that They Affected the Market, as a Predicate to Class Certification.

Petitioners argue that courts should require securities plaintiffs to prove the materiality of defendants' misrepresentations as a prerequisite to class certification. *Amici* submit that the critical question is not whether the issue of materiality overlaps with the merits, but whether establishing materiality is necessary as a prerequisite to determining that common questions predominate in the case. It is not. While materiality may be a predicate to showing reliance on the defendant's misrepresentations, it is *not* a prerequisite to showing all that Rule 23 requires, which is simply that reliance can be adjudged at trial as a common question subject to unitary proof for all class members.

Petitioners compound their error by asserting that plaintiffs should have to prove market impact in addition to meeting this Court's established test for materiality. As defined by this Court, materiality is a distinct concept from market impact. And in any event, market impact—like materiality—is a common question subject to unitary proof. As such, it is irrelevant to the Rule 23 inquiry.

A. Materiality is not a legal predicate for class certification under the fraud-on-the-market theory.

Although Rule 23 imposes a number of requirements for certifying a plaintiff class, fraud-on-the-market cases generally revolve around the question of commonality. In

such cases, the sole question is whether "the questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). It is true that this Court has said that plaintiffs will sometimes have to prove matters that are also merits issues to meet the requirements for class certification. *See Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2552 n.6 (2012). But merits issues are relevant only insofar as they go to the actual prerequisites that Rule 23 requires. Plaintiffs must show that common issues predominate, for example, but Rule 23 does *not* require a showing that plaintiffs actually relied on the defendants' misrepresentations or that plaintiffs were harmed. Likewise, plaintiffs under *Basic* must show that the stock in question traded in an efficient market, but that is only because so doing will allow them to establish reliance on a unitary basis at trial.

Petitioners' position would make sense if the point of the fraud-on-the-market theory was to establish that a misrepresentation had *harmed* each member of the plaintiff class. But courts invoke fraud-on-the-market only to answer a much narrower question: whether plaintiffs' claims (particularly the element of reliance) can be established on a common, class-wide basis. What *Basic* presumes is that a purchaser of a security traded in an efficient market relies on *all* material public statements, because all of those statements will be incorporated in the security's price. That is all that is required to determine that the reliance question is common to all class members. At class certification, courts can remain agnostic as to whether the alleged misrepresentations are material, because materiality is inherently a common question. *Basic* simply presumes that *if* the misrepresentation is

material, then it will have been incorporated in the stock price and relied upon—in a unitary way—by each member of the plaintiff class.

Basic's references to materiality in its discussion of the fraud-on-the-market presumption should be read in this light. At no point in its opinion did the *Basic* Court state that materiality is a *prerequisite* for class certification. Rather, what the Court said was that, in an efficient market, courts should presume that plaintiffs rely on material statements and misrepresentations. Hence, the Court said that "[f]or purposes of accepting the presumption of reliance ... we need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices." 485 U.S. at 246 n.24. In an efficient market, in other words, plaintiffs may establish that the whole class relied by showing that the relevant statements were material. But what Petitioners forget is that class certification does not require proof of *reliance*; rather, a class may be certified if plaintiffs can show that reliance will be provable on a unitary basis.[37] As long as

37. References to materiality or effects on market price in this Court's more recent cases are of a similar character. *See Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005) (describing *Basic* as "presuming that the price of a publicly traded share reflect a material misrepresentation and that plaintiffs have relied upon that misrepresentation"); *cf. Halliburton*, 131 S. Ct. at 2182 (describing "*Basic*'s fundamental premise" as being "that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction"). In each instance, the Court invokes materiality as a way to establish reliance in an efficient market, but the Court never suggests that establishing reliance is necessary for *class certification*. Rather, all that is necessary is to show that reliance

the market for the relevant security is efficient, plaintiffs can show reliance at trial simply by making one showing that the misrepresentations in question were material.

B. Economic proof of market impact is not the same thing as materiality, and in any event market impact is always a common question.

This Court has held that a statement is material when there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1318 (2011) (quoting *Basic*, 485 U.S. at 231-32). This standard is grounded in the attitude of the reasonable investor, not on a demonstration of quantifiable market impact from a particular statement.[38] It is altogether possible, for example, that a reasonable investor might find that a particular statement "altered the total mix of information," even if the market impact of that particular statement cannot be teased out from the total effect of all news and developments that affected the market at a given moment.

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may be proven for the class as a whole, without individualized proof. This is why, in *Halliburton*, the Court described the *Basic* presumption as having only three elements—"that the alleged misrepresentation were publicly known ... that the stock traded in an efficient market, and that the relevant transaction took place 'between the time the misrepresentations were made and the time the truth was revealed,'" 131 S. Ct. at 2185 (quoting *Basic*, 485 U.S. at 248)—without mentioning materiality.

38. *See, e.g.*, *Basic*, 485 U.S. at 240 ("[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information.").

In any event, questions about market impact are concededly common ones and thus no barrier to class certification. As Petitioners' *amici* explain, market impact would have to be proven by event studies that attempt to tease out the impact of the particular statements or omissions that form the basis for the plaintiffs' claims. *See* Law Professors' Brief at 27-30. No one contends, however, that market impact is not a common question, and the methods of economic proof that Petitioners' *amici* propose—manageable or not—are unitary in nature. Plaintiffs' claims of market impact, in other words, will stand or fall as a class; hence, resolution of that issue cannot be a predicate to class certification.

C. Economic revisionism is not a valid basis for overruling this Court's statutory precedents.

Petitioners and their *amici* pervasively stress the impact of class certification on the settlement dynamics of securities fraud litigation. At bottom, Petitioners argue that materiality should be a prerequisite to certification not because proof on that issue is necessary to determine whether common issues predominate, but simply because "[i]f materiality is not determined before class certification, it frequently will not be considered at all." Petitioners' Brief at 24. But concerns about settlement pressures are not a reason to add new requirements to Rule 23 or to alter this Court's interpretation of Congress's intent in *Basic*. Congress, after all, has not been inattentive to concerns about class action litigation in securities cases, but it has chosen not to impose the requirements that Petitioners now ask this Court to invent.

Critically, this Court's adoption of the fraud-on-the-market presumption in *Basic* rested not on the Court's own view of economic theory, but on Congress's intent in the securities laws. As this Court noted, "Congress expressly relied on the premise that securities markets are affected by information, and enacted legislation to facilitate an investor's reliance on the integrity of those markets." 485 U.S. at 246. Similarly, the SEC has stated that its Form S-3, which applies to registrations of most corporations relevant to this discussion, "is predicated on the Commission's belief that the market operates efficiently for these companies, *i.e.*, that the disclosure in Exchange Act reports and other communications by the registrant, such as press releases, has already been disseminated and accounted for by the market place." Exchange Act Release No. 6331, 46 Fed. Reg. 41,902 (Aug. 18, 1981). SSEMH and its fraud-on-the-market corollary is thus entrenched in Congress's own understanding of the Securities Exchange Act as well as in the Act's implementation by the SEC.

This Court has recognized "the 'special force' of the doctrine of stare decisis with regard to questions of statutory interpretation." *Global-Tech Appliances, Inc. v. SEB S.A.*, 131 S. Ct. 2060, 2068 (2011) (quoting *John R. Sand & Gravel Co. v. United States*, 552 U.S. 130, 139 (2008)). Even if a consensus of economists had rejected the SSEMH, this Court would hesitate to rewrite a statutory scheme predicated on the belief that securities markets efficiently incorporate information. Fortunately, there is no conflict between economic consensus and *stare decisis* here. While research revealing anomalies in the market may be relevant for theoretical purposes, these revisionist critiques do not undermine the SSEMH as it operates in

the practical context of securities litigation. Rejecting the SSEMH would thus fly in the face of economic consensus *and* upset the fundamental assumptions of the regulatory scheme that Congress enacted.

CONCLUSION

The judgment of the United States Court of Appeals for the Ninth Circuit should be affirmed.

Respectfully submitted,

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AMICUS CURIAE BRIEF

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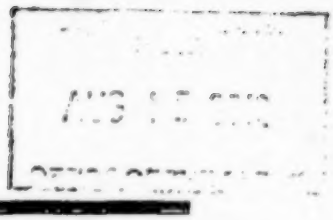

No. 11-1085

In the Supreme Court of the United States

AMGEN INC., ET AL.,

Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF FORMER SEC COMMISSIONERS AND OFFICIALS AND LAW AND FINANCE PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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BRIEF *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF THE *AMICI CURIAE*

The *amici curiae* are former Commissioners and officials of the United States Securities and Exchange Commission (SEC), as well as prominent law and finance professors whose fields of academic inquiry include securities regulation and litigation, class-action practice, and law and economics.[1] *Amici* have devoted substantial parts of their professional careers to drafting, implementing, and/or studying the federal securities laws, including how those laws should be interpreted to ensure the protection of investors and the promotion of efficiency, competition, and capital formation. *Amici* previously filed an *amicus* brief in support of petitioners at the certiorari stage of this case.

This brief reflects the consensus view of the *amici* that this Court should reverse the Ninth Circuit's decision. *Amici* observe that the logic and purposes of the fraud on the market doctrine and of the Rule 23 class action device require that, in order to obtain class certification, Section 10(b) plaintiffs seeking money damages must establish by a preponderance of the evidence that defendants' alleged misrepresentations were material in the sense that they affected the price of the stock at issue. Each individual *ami-*

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[1] Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part and that no person other than *amici* and their counsel made a monetary contribution to its preparation or submission. The parties' letters consenting to the filing of this brief have been filed with the Clerk's office.

cus may not endorse every argument presented in this brief, however. The former SEC Commissioners, former SEC officials, and professors joining this brief as *amici* are listed alphabetically below:

The Honorable Paul S. Atkins served as a Commissioner of the SEC from 2002 to 2008.

Brian G. Cartwright served as General Counsel of the SEC from 2006 to 2009.

The Honorable Charles C. Cox served as a Commissioner of the SEC from 1983 to 1989, and as Chief Economist of the SEC from 1982 to 1983.

Professor Richard A. Epstein is the Laurence A. Tisch Professor of Law at New York University School of Law, the James Parker Hall Distinguished Service Professor of Law Emeritus and Senior Lecturer at the University of Chicago Law School, and the Peter and Kirsten Bedford Senior Fellow at the Hoover Institution.

Professor Allen Ferrell is the Greenfield Professor of Securities Law at Harvard University.

The Honorable Stephen J. Friedman is the President of Pace University and served as a Commissioner of the SEC from 1980 to 1981.

The Honorable Joseph A. Grundfest is the William A. Franke Professor of Law and Business at Stanford Law School and served as a Commissioner of the SEC from 1985 to 1990.

The Honorable Philip R. Lochner, Jr. served as a Commissioner of the SEC from 1990 through 1991.

The Honorable Aulana L. Peters served as a Commissioner of the SEC from 1984 through 1988.

Professor Amanda Rose is an Associate Professor of Law at Vanderbilt University.

Professor Kenneth E. Scott is the Ralph M. Parsons Professor of Law and Business Emeritus at Stanford Law School and Senior Research Fellow Emeritus at the Hoover Institute.

SUMMARY OF ARGUMENT

I.A. The Ninth Circuit's decision strikes at the heart of this Court's holding in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988). *Basic* recognized that in order to benefit from a presumption of class-wide reliance, a private securities fraud plaintiff seeking money damages must show at the class certification stage that the essential predicates to the fraud-on-the-market theory are satisfied. The crux of the fraud-on-the-market theory is that, in an efficient market, all public *material* information is reflected in the price of a security. An investor who purchases a security relying on the integrity of the market price thus relies on any *material* misrepresentations that have been made to the market, not because the investor is actually aware of any of these misrepresentations, but because the effect of the material misrepresentation is incorporated into the stock price, and not for any other reason.

Materiality in the form of information that is incorporated into securities prices is thus a necessary condition precedent to the very theory that makes class certification of private Section 10(b) money damages claims possible. *Basic* recognized that whenever the link between an alleged misrepresentation and the market price of a security is severed, the presumption of reliance is inapplicable and class certification is improper. The Ninth Circuit failed to

follow these important principles when it held that a Section 10(b) plaintiff need not demonstrate materiality in any form whatsoever in order to obtain class certification in an action for money damages.

I.B. That materiality is a necessary predicate in establishing the presumption of reliance means that it is also a necessary predicate in determining whether a suit may be certified as a class action under Federal Rule of Civil Procedure 23. *Basic* explained that a Section 10(b) case can *only* be tried in a class action format if the presumption of reliance applies. Otherwise, individual reliance issues predominate over common issues and Rule 23(b)(3) cannot be satisfied. See *Basic*, 485 U.S. at 242 (the need for "proof of individualized reliance from each member of the proposed plaintiff class" would have "prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones").

If a representation was not material in the sense of influencing the security's price then there is no basis for concluding that investors acted "in reliance on the integrity of the [market] price" that was at all affected by the alleged misrepresentation. See *Basic*, 485 U.S. at 247. Accordingly, plaintiffs must establish that an alleged misrepresentation was both material and impounded into the market price of shares in order to show that reliance on the misrepresentation is an issue common to all class members.

The Ninth Circuit's misunderstanding of *Basic* and the role of materiality in the Rule 23 inquiry has significant implications. Because securities class actions are nearly always settled if a class is certified, the materiality and price impact of an alleged misstatement will never be tested unless the question is

examined as part of the Rule 23 inquiry. Plaintiffs' allegations of reliance therefore will therefore never be tested either. The Ninth Circuit's decision unleashes the *in terrorem* power of class certification to compel settlement of even questionable claims without any meaningful inquiry into materiality or price impact and, therefore, into an important aspect of the propriety of presuming reliance. *Basic*, however, establishes that these are critical issues that must be tested at the class certification stage.

I.C.1. The rule proposed by *amici* would not impair the ability of the SEC to enforce the federal securities laws. The SEC in civil enforcement actions is not required to establish reliance or causation. The SEC therefore need not depend on the fraud-on-the-market theory, and need not prove materiality by way of price impact. In this federal enforcement context, a statement may be shown to be material if there is a "substantial likelihood" that a "reasonable investor" would view it "as having significantly altered the 'total mix'" of available information, even if it has no price impact. *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976). And, while proof of price impact would definitively satisfy that standard, the absence of a reliance or causation element or need to rely on the fraud-on-the-market theory means that other evidence may also satisfy the standard in a particular case.

I.C.2 The Ninth Circuit's expansive interpretation of the fraud-on-the-market doctrine untethers the class certification determination from even the most cursory consideration of materiality. The decision below is therefore directly contrary to this Court's recent admonitions that the Section 10(b) implied private right of action is to be interpreted

narrowly. See, *e.g.*, *Janus Capital Group, Inc.* v. *First Derivative Traders*, 131 S. Ct. 2296, 2303 (2011); *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 167 (2008).

I.D. Nothing in this Court's decision in *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179 (2011), casts any doubt on the rule of decision urged by *amici*. *Halliburton* explains that the fraud-on-the market theory depends on the principle that material information is impounded in the price of a security, but that loss causation requires more: a showing "that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss." 131 S. Ct. at 2186; see also *Dura Pharm., Inc.* v. *Broudo*, 544 U.S. 336, 342 (2005). "Loss causation" therefore "has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory." 131 S. Ct. at 2186. Materiality, by contrast, is central to that inquiry, and therefore must be shown in order to obtain class certification.

II. The Court should take the opportunity afforded by this case to define the burden of proof a plaintiff bears to establish the prerequisites for class certification in a Section 10(b) suit. Although the courts of appeals are trending towards the recognition that the usual standard that applies in civil cases—proof by a preponderance of the evidence—also governs at the class certification stage, some confusion remains about that question. To guide the courts and parties below, and to avoid the inefficiency of having eventually to resolve this matter after the expenditure of further judicial and private party resources, *amici* believe it appropriate for this Court

to hold in this case that the normal civil burden applies.

ARGUMENT

I. PLAINTIFFS MUST DEMONSTRATE MATERIALITY BY SHOWING PRICE IMPACT BEFORE A CLASS MAY BE CERTIFIED IN A SECTION 10(b) SUIT FOR DAMAGES.

A. *Basic* Establishes That The Presumption Of Reliance Applies Only When It Is Shown That Material Information Is Incorporated Into The Price Of A Stock.

1. In *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), this Court explained that "[t]he paradigm of a fraud on the market litigation [was] a class action brought by purchasers of stock alleging that over a period of time the stock prices were artificially inflated due to material misstatements contained in publicly available corporate documents." Barbara Black, *Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C. L. REV. 435, 435-437 (1984) (cited in *Basic*, 485 U.S. at 247 n.26). Thus, the artificial inflation or deflation of a stock price was clearly perceived as central to the notion of materiality that lies at the core of a class action claim for money damages.

Basic itself involved a claim that a corporation had misled investors by artificially depressing the price of its stock through false representations about the material question of whether there was a plan for the corporation to be acquired. The plaintiffs' complaint was thus of a material misrepresentation with a clear price impact, and the *Basic* court never had occasion even to consider whether a material misrepresentation without a price impact could support a

fraud on the market claim. Indeed, the entire logic of the Court's plurality decision in *Basic* is inconsistent with the notion that materiality absent a price impact could support the fraud on the market presumption.[2]

From the start, therefore, the essential link between materiality and price impact has been clear. There is no question that *Basic*'s core premise is "that an investor presumptively relies on a misrepresentation *so long as it was reflected in the market price at the time of his transaction.*" *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011) (emphasis added). *Basic* thus stands firmly for the proposition that the fraud-on-the-market theory does not apply—and that plaintiffs are not entitled to a presumption of reliance—unless they can demonstrate that the alleged misrepresentations were material in the sense that they had an impact on the price of the shares they traded.

This Court's recognition that price impact is an essential predicate to the application of the fraud on the market theory is evident in every facet of *Basic*'s discussion of the fraud-on-the-market theory. Indeed, the rebuttable presumption of reliance recognized in *Basic* makes no sense if the alleged misrepresentations did not impact the price of the plaintiffs' shares.

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[2] We do not suggest that materiality always requires price impact. See pp. 17-19, *infra*. But in a private cause of action under Section 10(b) for damages, where reliance is to be proved by presumption, price impact is necessary to establish that the fraud-on-the-market theory applies and that reliance may therefore be presumed.

"Reliance by the plaintiff upon the defendant's deceptive acts * * * ensures that, for liability to arise, the 'requisite causal connection between a defendant's misrepresentation and a plaintiff's injury' exists as a predicate for liability." *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008), quoting *Basic*, 485 U.S. at 243. And reliance may be presumed under the fraud-on-the-market theory only when the misrepresentation is *material* and "is reflected in the market price of the security." *Ibid.* Only then can it "be assumed that an investor who buys or sells stock at the market price relies upon the statement." *Ibid.* Unless a misstatement is material because it affects the market price, "the basis for finding that the fraud had been transmitted through market price would be gone." *Basic*, 485 U.S. at 248.[3]

Some courts of appeals have understood this relationship between materiality and price impact in fraud-on-the-market cases. The Third Circuit, for example, correctly explained in *Oran* v. *Stafford*, 226 F.3d 275, 282 (3d Cir. 2000), that the concept of materiality must be "shaped by the basic economic insight that in an open and developed securities market," the "price of a company's stock is determined by all available material information regarding the company and its business." The court observed that "[i]n such an efficient market, 'information important to reasonable investors * * * is immediately incorporated into the stock price,'" and explained that be-

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[3] *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153-154 (1972), which establishes a presumption of reliance in omissions cases, also requires that the omission be "material." The omissions in *Affiliated Ute* had a price impact, and thus were material. See *id.* at 147 & n.14.

cause "'*the concept of materiality translates into information that alters the price of the firm's stock*,' if a company's disclosure of information has no effect on stock prices, 'it follows that the information disclosed * * * was immaterial as a matter of law.'" *Ibid.* (emphasis added). See also, *e.g.*, *Shaw* v. *Digital Equip. Corp.*, 82 F.3d 1194, 1218 (1st Cir. 1996) ("by its underlying rationale, the presumption [of reliance under the fraud-on-the-market theory] shifts the critical focus of the materiality inquiry" to "'whether the market as a whole was fooled,'" "because it is the market, not any single investor, that determines the price of a publicly traded security").

Considerations of "common sense and probability," this Court explained in *Basic*, support a presumption of reliance when—but only when—plaintiffs traded shares "after the issuance of a materially misleading statement by the corporation" that was "reflected in [the] market price" of those shares. 485 U.S. at 226, 246-247. Where a stock price is not moved by a misstatement of fact, that misstatement either is immaterial or the market is inefficient—and in either case "common sense" and "probability" would not support a presumption of reliance. See, *e.g.*, ANDREI SHLEIFER, INEFFICIENT MARKETS: AN INTRODUCTION TO BEHAVIORAL FINANCE 5 (2000) (a key prediction of efficient market theory is that "prices should not move without any news about the value of the security"); Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 509 (2006) ("The definition of immaterial information * * * is that it is already known or * * * does not have a statistically significant effect on stock price in an efficient market"); Allen Ferrell & Atanu Saha, *The Loss Causation Requirement for Rule 10b-5 Causes of Action:*

The Implications of Dura Pharmaceuticals, Inc. *v.* Broudo, 63 BUS. LAW. 163, 166 (2007) ("actionable misconduct must *cause* economic losses to shareholders who purchased shares at an inflated price").[4]

2. Significantly, this Court's discussion in *Basic* of the circumstances in which the fraud-on-the-market presumption of reliance does *not* apply further confirms that a material misstatement that fails to impact stock price cannot support the application of the fraud on the market presumption.

First, as this Court explained, plaintiffs are not entitled to a presumption of reliance if the defendant demonstrates that the alleged misrepresentations did not impact the price of the plaintiffs' securities. "Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance." 485 U.S. at 248.

By way of example, the Court explained that "if [defendants] could show that the 'market makers' were privy to the truth * * * and thus that *the market price would not have been affected* by their misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone." 485 U.S. at 248 (emphasis added). But that is precisely the showing—*i.e.*, the absence of price impact—that the Ninth Circuit would prevent any defendant from

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[4] Price impact is also critical to materiality in the case of a confirmatory misstatement. Plaintiffs, to establish materiality and establish the presumption of reliance, must prove that a confirmatory misstatement maintained the price impact of the misstatement it confirmed.

making at the class certification stage in any class action securities fraud litigation.

Similarly, this Court explained that "if, despite * * * allegedly fraudulent attempt[s] to manipulate market price, news * * * credibly entered the market and dissipated the effects of the misstatements, those who traded * * * after the corrective statements would have no direct or indirect connection with the fraud." 485 U.S. at 248-249. To say that the "effects of the misstatements" were "dissipated" is precisely to say that the misstatements did not affect the price of the securities at the time plaintiff purchased them. Here too, *Basic* makes clear that price impact is essential to a showing of materiality.

In sum, *Basic* establishes that unless plaintiffs can show that the alleged "fraud had been transmitted through market price," and is thus material because it affected the market price, they are not entitled to a presumption of reliance. 485 U.S. at 248. It follows from *Basic*'s core holding that in an action for money damages, plaintiffs must show not merely that representations in general contained "material" misinformation in the sense that there is a "substantial likelihood" that the information "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976); accord *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1318 (2011). Instead, to support the application of the fraud-on-the-market rebuttable presumption, plaintiffs must demonstrate that the material information was "reflected in," and "[led] to a distortion of," the "market price" of the plaintiffs' securities. *Basic*, 485 U.S. at 247-248.

B. A Class May Not Be Certified Under Rule 23 Unless Plaintiffs Establish That A Material Misrepresentation Affected The Price Of The Stock.

1. That materiality through the price impact of an alleged misstatement is a necessary predicate for establishing the presumption of reliance logically implies that it is also a necessary predicate for determining whether a suit may be certified as a class action. As the drafters of Rule 23 explained, the "critical need" at the class certification stage is to determine "the nature of the issues that actually will be presented at trial"—"how the case will be tried." Fed. R. Civ. P. 23, Advisory Comm. Notes to the 2003 Amendments. As *Basic* held, a Section 10(b) case can *only* be tried as a class action if the presumption of reliance apples. Otherwise, individual issues of reliance predominate over common issues and Rule 23(b)(3) is not satisfied. See *Basic*, 485 U.S. at 242 (the need for "proof of individualized reliance from each member of the proposed plaintiff class" would have "*prevented respondents from proceeding with a class action*, since individual issues then would have overwhelmed the common ones") (emphasis added); see also *Halliburton*, 131 S. Ct. at 2184 ("[w]hether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance").

If a representation was not material in the sense that it was not reflected in the price of a security then there is no basis for concluding that any investor relied on it by virtue of trading "in reliance on the integrity of the [market] price." See *Basic*, 485 U.S. at 247. Thus, if plaintiffs fail to establish prior to class certification that an alleged misrepresentation

was impounded in the market price of their shares, they also fail to show that reliance is a common issue that binds together their claims. Individual reliance issues then predominate and are an absolute bar to class certification.

2. Postponing inquiry into the materiality of an alleged misrepresentation until after the class certification stage, as the Ninth Circuit held should be done, would "[a]llo[w] plaintiffs to circumvent the reliance requirement" altogether and thereby to "disregard the careful limits on 10b-5 recovery mandated by [this Court's] earlier cases." *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180 (1994). "A district court's ruling on the certification issue is often the most significant decision rendered in * * * class-action proceedings." *Deposit Guarantee Nat'l Bank* v. *Roper*, 445 U.S. 326, 339 (1980). If a class action seeking substantial damages is certified, the case is almost always then settled before any trial on the merits. Indeed, the data suggest that only 8 percent of all federal class action securities fraud claims ever result in a ruling on a motion for summary judgment. Of the 92% of cases resolved prior to issuance of a ruling on summary judgment, 41% are dismissed, and 51% are settled.[5] Thus, unless the materiality of an alleged misstatement is tested at the Rule 23 stage, there is only an 8 percent chance that the average class action securities fraud complaint will ever be tested at all beyond the application of liberal pleading requirements pursuant to which plaintiffs' allegations are accepted as

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[5] Stanford Law School and Cornerstone Research, *Securities Class Action Filings, 2011 Year in Review* 18 & Figure 16, http://securities.stanford.edu.

true. *Bell Atlantic Corp.* v. *Twombly*, 550 U.S. 544, 555-556 (2007) (plaintiffs' allegations accepted as true at pleading stage).

It is well understood that, if a class is certified in a securities fraud case, the risks of trial to the defendant are so significant that settlement is usually the defendant's only option. *E.g.*, Fed. R. Civ. P. 23(f), 1998 Advisory Comm. Note ("An order granting certification" may "force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability"). This Court has recognized that "[e]ven weak cases brought under [Rule 10b-5] may have substantial settlement value." *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Dabit*, 547 U.S. 71, 80 (2006). The "*in terrorem*" prospect of "extensive discovery," "disruption of normal business activities," and the risk of a potentially massive adverse jury verdict gives even an insubstantial claim "a settlement value to the plaintiff out of any proportion to its prospect of success at trial." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740-743 (1975). And these large settlements are "'payable in the last analysis by innocent investors'"—the defendant company's current shareholders. *Id.* at 739, quoting *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968).

It is commonly appreciated that "'blackmail settlements,'" "induced by a small probability of an immense judgment," are a serious problem with the class action device in large securities fraud cases. *In re Rhone-Poulenc Rohrer, Inc.*, 51 F.3d 1293, 1298 (7th Cir. 1995), quoting HENRY J. FRIENDLY, FEDERAL JURISDICTION: A GENERAL VIEW 120 (1973); see THOMAS E. WILLGING, ET AL., EMPIRICAL STUDY OF CLASS ACTIONS IN FOUR FEDERAL DISTRICT COURTS: FINAL

REPORT TO THE ADVISORY COMMITTEE ON CIVIL RULES 179, Tables 39 & 40 (Federal Judicial Center 1996). The costs and risks of litigation can make the merits of such claims largely irrelevant. *E.g.*, Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 516-517 (1991); Joseph A. Grundfest, *Why Disimply?*, 108 HARV. L. REV. 727, 742-743 (1995). Once a class is certified the risks of the suit are magnified and settlement becomes the predictable outcome.

Securities fraud actions are not intended "to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause"—*i.e.*, losses caused by misrepresentations of *material* fact that, at a minimum, have an impact on the price paid or received for securities. *Dura Pharm.*, 544 U.S. at 345, citing *Basic*, 485 U.S. at 252. But taking materiality and price impact out of the equation at the class certification stage means in practice that materiality and price impact need only be adequately pled, never proved, even though materiality and price impact are essential ingredients of the presumption needed to establish reliance on a common, class-wide basis. Courts must "be especially alert" to prevent this sort of "class-action harassment." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 345 (1979). But as the Ninth Circuit's decision shows, such "harassment" will persist without a clear ruling from this Court that in a Section 10(b) case for money damages, plaintiffs seeking class certification must demonstrate that the alleged misstatements actually moved the market price of their shares.

C. Requiring Proof of Materiality At The Class Certification Stage of Private Damages Actions Furthers Investor Protection and Economic Efficiency.

1. Requiring proof of materiality at the class certification stage also comports with this Court's efforts to confine the judge-made implied private right of action under Section 10(b). This Court has consistently resisted expansive readings of the implied right, recognizing that private securities litigation is susceptible to abuse. *Janus Capital Group, Inc.* v. *First Derivative Traders*, 131 S. Ct. 2296, 2303 (2011) (giving the implied private right of action a "narrow scope"); *Stoneridge Inv. Partners* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 167 (2008) ('private right of action must be given "narrow dimensions"); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 736 (1975); *Dura*, 544 U.S. at 347 (expressing concerns about "'abusive' practices"); see David S. Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision Of Legislative Intent?*, 57 NW. U.L. REV. 627, 660 (1962) (because it is implied, the private right under Rule 10b-5 "should be interpreted with caution").

This Court has invoked "policy considerations" in repeatedly rejecting "expansive imposition of civil liability" under Section 10(b). *Blue Chip Stamps*, 421 U.S. at 737, 739, 748. In particular, the Court has limited the scope of Section 10(b) actions to curtail their coercive potential and make meritless claims easier "'to dispose of before trial.'" *Id.* at 742-743; see *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) (requiring proof of scienter, not mere negligence); *TSC Indus.*, 426 U.S. at 449 (rejecting lax definition of materiality); *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462 (1977) (limiting Section 10(b) to manipulative or

deceptive conduct); *Central Bank*, 511 U.S. at 189 (rejecting aiding and abetting claims because they would engender "uncertainty and excessive litigation"); *Dura*, 544 U.S. at 346 (requiring that loss causation be pled). Addressing at the class certification stage whether plaintiffs are able to demonstrate materiality is fully in keeping with these policy considerations.

2. Securities fraud class action plaintiffs routinely argue that requiring them to satisfy any threshold requirement serves as a disincentive to filing those suits, the threat of which they say is necessary to deter fraud. But that contention has no merit in this case, and it is flatly inconsistent with a long line of decisions from this Court imposing limits on the judge-made Section 10(b) implied private right of action.

The rule proposed by *amici* would not at all impair the ability of the Securities and Exchange Commission to enforce the federal securities laws. "The United States has the toughest administrative enforcement of securities laws in the world." INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 11 (2006). The SEC employs a broad range of statutory and administrative tools to combat fraud, including civil actions in which it *is not required to establish either reliance or causation*, and which are therefore likely to be much more effective in deterring fraud than the judicially implied private right of action for damages. The SEC, in addition to having the power to seek large civil penalties and the disgorgement of any gains, may obtain injunctive relief and orders barring or suspending individuals from serving as an officer or director of an issuer of securities. See 15 U.S.C. §§ 78u, 78u-3. And the pe-

nalties and disgorgements it obtains may be used as "Fair Funds" to provide compensation to defrauded investors. See 15 U.S.C. § 7246. Securities fraud is also a criminal violation punishable by fines and imprisonment. See, *e.g.*, 15 U.S.C. § 78ff.

Rule 10b-5(b) requires the SEC to show in an enforcement action that an "untrue statement" was one of "material fact." But the SEC's burden is far lighter than that of a private plaintiff class seeking Rule 23 certification of a damages claim. A private plaintiff's burden to show at the class certification stage that an alleged misstatement had a price impact derives, as we have explained, from *Basic*'s holding that Rule 23 class certification is appropriate only if reliance may be presumed under the fraud-on-the-market theory. By contrast, in the public enforcement context, the SEC need not prove reliance or causation and the fraud-on-the-market theory is unnecessary to the SEC's success. Accordingly, there is no reason for courts to insist that the SEC make a showing of price impact as part of the materiality inquiry.

In this federal enforcement context, a statement may be shown to be material if there is a "substantial likelihood" that a "reasonable investor" would view it "as having significantly altered the 'total mix'" of available information, even if it has no price impact. *TSC Indus.*, 426 U.S. at 449. And while proof of price impact would definitively satisfy that standard, the absence of a reliance or causation element or need to rely on the fraud-on-the-market theory means that other evidence may also satisfy the standard in a particular case.

"Materiality" naturally is a context-driven concept, so it should be no surprise that it may be satisfied in different ways in the case of implied private

damages actions and express SEC enforcement actions. *E.g.*, *Earl v. Nielsen Media Research, Inc.*, 658 F.3d 1108, 1114 (9th Cir. 2011) ("Materiality depends on the context and is a question of fact that 'cannot be mechanically resolved'"); *Hawn v. Executive Jet Mgmt., Inc.*, 615 F.3d 1151, 1157 (9th Cir. 2010) ("Materiality will depend on context and the facts of the case"). Indeed, the Third Circuit has recognized that while *TSC* supplies the general rule of materiality in securities fraud cases, in those private actions for money damages where an efficient market is involved, price impact is the appropriate test of materiality. See *In re Constar Int'l Inc. Sec. Litig.*, 585 F.3d 774, 783 (3d Cir. 2009) ("We have * * * 'fashioned a special Rule for measuring materiality in the context of an efficient securities market.' * * * In that context, 'the materiality of disclosed information may be measured post hoc by looking to the movement, in the period immediately following disclosure, of the price of the firm's stock'"); see also *supra* pp. 9-10 (discussing similar cases).

D. Nothing In This Court's Ruling In *Halliburton* Relieves Section 10(b) Plaintiffs Of The Burden To Establish Materiality At The Class Certification Stage.

In *Erica P. John Fund* v. *Halliburton* this Court held that plaintiffs in private securities fraud actions need not prove loss causation in order to obtain class certification. Loss causation, however, is an entirely "distinct concept" from materiality and price impact. 131 S. Ct. at 2187; see, *e.g.*, *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1317 (2011). And, as this Court was at pains to explain in *Halliburton*, proving loss causation is not "a precondition for invoking *Basic*'s rebuttable presumption of reliance,"

but "addresses a matter different from" reliance. Indeed, "[t]he term 'loss causation' does not even appear in our *Basic* opinion." 131 S. Ct at 2186.

This Court explained that while the fraud-on-the-market theory depends on the principle that material information is impounded in the price of a security in an efficient market, loss causation requires "a plaintiff to show that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss." *Id.* at 2186 (emphasis added); see also *Dura Pharm.* v. *Broudo*, 544 U.S. 336, 342 (2005) (that a material misrepresentation inflated the price of a stock does not mean that the misstatement is also the cause of a later price decline). As *Halliburton* held, "[l]oss causation" therefore "has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory." 131 S. Ct. at 2186. Price impact can occur either with or without loss causation; these are separate inquiries.

By contrast, as we have explained above, proof that a misstatement was material, in that it moved the price of the stock, is essential under *Basic* to invoke the presumption of reliance, which is in turn necessary to satisfy Rule 23's predominance requirement. Although proof of loss causation is not necessary to obtain class certification, absent proof of materiality and of price impact, the fraud-on-the-market theory is not available to plaintiffs and the need for individualized proof of reliance defeats Rule 23 predominance and thus bars class certification. *Halliburton*, therefore, is not controlling here.

II. TO OBTAIN CLASS CERTIFICATION, SECTION 10(b) PLAINTIFFS MUST ESTABLISH MATERIALITY BY A PREPONDERANCE OF THE EVIDENCE.

The Court should require plaintiffs to prove materiality through price impact and all other prerequisites of Rule 23 certification by a preponderance of the evidence. This Court has not yet explicitly established the standard of proof for Rule 23 requirements, though in *Wal-Mart* it made clear that a plaintiff must meet more than "a mere pleading standard." *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541, 2551 (2011). The issue of the applicable standard is fairly encompassed in the questions presented as to whether Section 10(b) plaintiffs must prove materiality to obtain class certification, and what such proof entails. Resolving that issue here, rather than requiring parties and courts to devote resources to litigating the issue in the future, would be an efficient allocation of judicial resources and would appropriately guide the courts below in any remand in this case.

This Court left no doubt in *Wal-Mart* that a plaintiff "seeking class certification must *affirmatively demonstrate* his compliance with the Rule—that is, he must be prepared *to prove* that there are in fact sufficiently numerous parties, common questions of law or fact, etc." 131 S. Ct. at 2551. This Court also reaffirmed, as it had held in *Falcon*, that "certification is proper only if 'the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied.'" *Ibid.* (citing *Gen. Tel. Co.* v. *Falcon*, 457 U.S. 147, 161 (1982)). A court considering whether to certify a class action must "'probe behind the pleadings'" because "'actual, not pre-

sumed conformance with Rule 23(a)'" is "'indispensable.'" *Ibid.*, quoting *Falcon*, 457 U.S. at 160. This emphasis on the need for rigorous inquiry into whether plaintiffs have proved that Rule 23 is satisfied is impossible to reconcile with a lesser standard than proof by a preponderance of the evidence.

Indeed, this Court in *Wal-Mart* specifically addressed, in the course of its analysis, the fraud-on-the-market presumption in "class-action suits for securities fraud," stating unequivocally that "plaintiffs seeking 23(b)(3) certification must *prove* that their shares were traded on an efficient market," even though "they will surely have to prove" that issue "*again* at trial in order to make out their case on the merits." 131 S. Ct. at 2552 n.6 (first emphasis added). That the Court equated plaintiffs' burden of proof on the merits with their burden of proof at the class certification stage to establish that the Rule 23 requirements are satisfied surely means that the preponderance standard that governs on the merits also governs at the certification stage.

The 2003 amendments to Rule 23 confirm that the preponderance standard is appropriate. Those amendments call for a court to make "findings" that Rule 23 prerequisites are met based on a developed record. Fed. R. Civ. P. 23(b)(3); Fed. R. Civ. P. 23, 2003 Advisory Comm. Note. And when amended Rule 23(c)(1)(A) altered the timing of the class certification decision, from "as soon as practicable" to "at an early practicable time," it did so according to the Committee Notes to allow time for class-certification-related discovery necessary to facilitate "prob[ing] behind the pleadings." These changes, with their focus on discovery and fact-findings, strongly suggest

that the usual preponderance standard for proof of facts should apply.

Since the 2003 amendments, the Second, Third, and Fifth Circuits have expressly held that Rule 23 prerequisites must be proved by a preponderance of evidence. The Second Circuit was the first to reject the weaker "some showing" standard in favor of the preponderance standard. *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 39-42 (2d Cir. 2006) (*IPO*). In doing so the court analogized the class certification decision to a trial court resolving personal or subject matter jurisdiction, which often involves "resolv[ing] underlying factual disputes, and, as to these disputes, the judge must be persuaded that the fact at issue has been established." *Id.* at 40. The Second Circuit directed district courts "to assess all of the relevant evidence admitted at the class certification stage" to "resolv[e] factual disputes relevant to each Rule 23 requirement," and "[to] fin[d] that whatever underlying facts are relevant to a particular Rule 23 requirement have been established," notwithstanding an issue's overlap with the merits. *Id.* at 41-42. The Second Circuit later reiterated that *IPO* requires district courts to apply the preponderance standard to establish Rule 23 requirements. *Teamsters Local 445 Freight Div. Pension Fund* v. *Bombardier Inc.*, 546 F.3d 196, 202-203 (2d Cir. 2008).

The Third and Fifth Circuits subsequently joined the Second in adopting a preponderance of evidence standard. The Third Circuit held unequivocally that "[f]actual determinations necessary to make Rule 23 findings must be made by a preponderance of the evidence." *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 320 (3d Cir. 2008). The Fifth Circuit also adopted the preponderance standard. See

Alaska Elec. Pension Fund v. *Flowserve Corp.*, 572 F.3d 221, 228-229 (5th Cir. 2009). In so doing, it observed that "a district court's certification order often bestows upon plaintiffs extraordinary leverage, and its bite should dictate the process that precedes it." *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261, 267 (5th Cir. 2007), abrogated in other respects by *Halliburton*, 131 S. Ct. 2179. Given the enormous settlement leverage that comes from certification of a class action, certification should be ordered only when the evidence shows it is warranted—not merely when Rule 23 factors have been alleged, or some showing has been made that they are satisfied. There is no reason to depart from the usual standard of proof when facts are in dispute and when so much turns on the court's ruling.

Here, the Ninth Circuit held that the plaintiff must merely plausibly allege—but need not prove—materiality at the class certification stage. *Amgen*, 660 F.3d at 1172. Although the court acknowledged that the plaintiff must prove the other elements of Rule 23, the Ninth Circuit did not describe the evidentiary standard that applies to Rule 23. Nor has the Ninth Circuit done so elsewhere. See *Cholakyan* v. *Mercedes-Benz, USA, LLC*, 2012 WL 1066755, at *11 n.88. (C.D. Cal. Mar. 28, 2012) (finding no Ninth Circuit case that establishes the applicable standard of proof). This Court should embrace the reasoning of the Second, Third, and Fifth Circuits and, consistent with the rigorous analysis it required in *Wal-Mart*, adopt the preponderance of the evidence standard for Rule 23 class certification.

CONCLUSION

The judgment of the Ninth Circuit should be reversed.

Respectfully submitted.

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AMICUS CURIAE BRIEF

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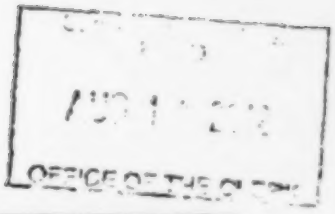

No. 11-1085

In the Supreme Court of the United States

AMGEN INC., ET AL., PETITIONERS

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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Brief for Law Professors as *Amici Curiae* Supporting Petitioner, *Erica P. John Fund, Inc.* v. *Halliburton*, 131 S. Ct. 2179 (No. 09-1403).....31, 32

INTEREST OF *AMICI CURIAE*[1]

Amici are law professors whose scholarship and teaching focuses on corporate law and the federal securities laws. Law professors have an interest in ensuring that the securities laws are interpreted to accurately reflect both current financial economic scholarship and the historical underpinnings of the securities laws. *Amici* filed a brief *amici curiae* in *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179 (2011) (No. 09-1403), addressing the consideration of market impact and the fraud on the market theory at the class certification stage of Rule 10b-5 securities fraud suits.

Amici include Adam C. Pritchard, the Frances and George Skestos Professor of Law at the University of Michigan Law School; and M. Todd Henderson, Professor of Law at the University of Chicago Law School.

SUMMARY OF ARGUMENT

In *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), the Court held that in a Rule 10b-5 securities fraud suit, plaintiffs may invoke a "presumption of reliance" to gain class certification under Federal Rule of Civil Procedure 23(b)(3), which requires that common questions of law or fact "predominate" over questions particular to individual class members' claims. *Id.* at

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[1] No counsel for a party authored this brief in whole or part, and no counsel or party made a monetary contribution to fund the preparation or submission of this brief. No person other than the *amici curiae* and their counsel made any monetary contribution to its preparation and submission. The parties have filed letters giving blanket consent to the filing of *amicus* briefs in this case.

241-48. *Basic* held that this presumption was supported by the "fraud on the market theory," which provides that "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price." *Id.* at 247, 250.

Basic grounded its holding on the understanding that "the market price of shares traded on well-developed markets reflects all publicly available information," including "any public material misrepresentations"—a concept embodied in the "efficient capital markets theory." *Id.* at 246-47 & n.24. *Basic* reasoned that because every public material misrepresentation is reflected in a security's price, "an investor's reliance on any public material misrepresentations * * * may be presumed for purposes of a Rule 10b-5 action." *Id.* at 247.

Basic thus combined two distinct concepts: the fraud on the market theory and the efficient capital markets hypothesis. The efficient capital markets hypothesis is not necessary to the use of the fraud on the market theory—as long as the market for a security incorporates the fraudulent information into the price, a "fraud on the market" has occurred, whether the market is efficient or not. But the two concepts can be combined to allow plaintiffs to invoke a presumption of reliance as to a particular instance of alleged fraud if they can first demonstrate that the relevant market was "efficient," *i.e.*, that it "reflect[ed] all publicly available information." *Id.* at 246. In the years before *Basic*, scholars and lower courts championed the simultaneous application of these concepts in the belief that well-developed markets were efficient, and that stock prices within those markets reflected all public information. And

while *Basic* claimed "not to assess the general validity of" these theories, *id.* at 242, courts have nevertheless read *Basic* to accept them and to hold that a presumption of reliance is appropriate when market efficiency has been established.

But *Basic*'s view of the efficiency of capital markets was unrealistic. Rather than being totally "efficient" or "inefficient," securities markets enjoy varying degrees of efficiency, and therefore incorporate information at varying rates. Although *amici* accept that some well-developed markets incorporate most information into prices relatively quickly, empirical research conducted since *Basic* suggests that even the most open markets are not completely efficient, and will therefore incorporate some information slowly (or not at all). In light of this evidence, *Basic*'s understanding that a particular alleged fraud will necessarily be incorporated into the stock price is no longer sound.

Moreover, the lower courts' attempts to estimate efficiency have been inconsistent and empirically inaccurate. Faced with the difficult task of determining whether a market is "efficient"—a task for which they are ill-equipped—courts have resorted to examining proxies for efficiency as reflected in multifactor tests. Many of the proxies are highly correlated with each other (and therefore redundant), while others have little empirical relationship with efficiency; what is more, there is confusion about how to weigh the various factors. The result is a doctrinal and empirical muddle for both courts and litigants.

Use of the efficient capital markets hypothesis to show reliance becomes even more questionable when

one considers that the fraud on the market theory does not require it. Rather, the core inquiry in whether the fraud on the market presumption of reliance is appropriate is whether the market as a whole relied on allegedly fraudulent information. Therefore, all that is necessary is evidence of a particular misstatement's effect on a security's market price. In light of this, and of the difficulties in evaluating efficiency, the Court should shift the focus of fraud on the market inquiries from a market's overall efficiency to the question whether the fraud at issue affected market price. The decision below should be reversed because it focuses on efficiency at the class certification stage, rather than on the market effect of the alleged misstatements at issue.

ARGUMENT

I. *BASIC*'S USE OF MARKET EFFICIENCY AS A MEANS OF SHOWING RELIANCE IS UNNECESSARY AND COUNTERPRODUCTIVE

Plaintiffs bringing a Rule 10b-5 securities fraud claim must prove they relied upon the company's alleged misrepresentation when deciding to trade the company's security. *Basic*, 485 U.S. at 243. Traditionally, such reliance is determined on an individualized basis. Cf. *id.* at 242; see also *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 481 (2d Cir. 2008). But in the context of securities fraud class actions, which only can be maintained when common questions of law or fact predominate over individual questions, see Fed. R. Civ. P. 23(b), "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively

would * * * prevent[] [plaintiffs] from proceeding with a class action, since individual issues then would * * * overwhelm[] the common ones." *Basic*, 485 U.S. at 242.

In *Basic*, the Court allowed plaintiffs to invoke a "presumption of reliance" in lieu of showing individual reliance in class-action cases, by combining two then-new economic theories. The first of these was the semi-strong version of the efficient capital markets hypothesis, see *In re Res. Am. Sec. Litig.*, 202 F.R.D. 177, 189 n.12 (E.D. Pa. 2001), which postulates that "security prices fully reflect all available information," Eugene F. Fama, *Efficient Capital Markets: II*, 46 J. Fin. 1575, 1575 (1991); see *Basic*, 485 U.S. at 246 ("[T]he market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations."). Second was the fraud on the market theory, which provides that reliance may be presumed where "a fraud affects the price of a publicly traded security [because] investors will be affected even if they trade without knowledge of the misrepresentations that influenced the price at which they traded." *Stark Trading* v. *Falconbridge Ltd.*, 552 F.3d 568, 572 (7th Cir. 2009); accord *Basic*, 485 U.S. at 247.

Basic combines these two concepts in its conclusion that if a market is efficient, then all information, including any material misstatement, is incorporated into a security's price, and any investor buying a security when a misstatement is incorporated into the price relies on it by purchasing at the inflated price. *Basic*, 485 U.S. at 247. Combining these concepts, the *Basic* Court concluded:

> An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.

Id.

Although the Court noted that it would not "determine by adjudication what economists and social scientists have debated through the use of sophisticated statistical analysis and the application of economic theory," it also observed that then-recent "empirical studies have tended to confirm * * * that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." *Id.* at 246-47 & n.24.

Based on this language, courts and commentators have often interpreted *Basic* to allow plaintiffs to employ the fraud on the market theory only if they can demonstrate that the relevant market "reflects all publicly available information," a quality known as "efficiency."[2] See, *e.g.*, *Gariety* v. *Grant Thornton, LLP*, 368 F.3d 356, 368 (4th Cir. 2004) ("*Basic* clearly requires that a market be efficient in order for the

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[2] As discussed below, lower courts and commentators do not agree as to the level of efficiency necessary—just that some showing of a baseline of efficiency is required. Perfect efficiency is an unrealistic scenario. Fama, *supra*, at 1575 (stating that because there are information and trading costs in any market, the hypothesis that there is total market efficiency is "surely false").

fraud-on-the-market presumption of reliance to be invoked * * * ."). Although *Basic* indicated in a footnote that a market need only incorporate "most" information, see *Basic*, 485 U.S. at 246 n.24, other language in the opinion, see *id.* at 246, as well as many of the sources it cites, state that the relevant market must reflect "all" information to be efficient. See *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 11-12 (1st Cir. 2005) (collecting authorities).

As set forth below, however, an examination of the efficiency of markets is not necessary for determining reliance or establishing the existence of a fraud on the market; it is not even the best means of determining reliance, even in the context of class actions.

A. Examining Efficiency Is Unnecessary to Demonstrate "Fraud on the Market"

Although "*Basic* seems to insist on" a showing that a market is efficient to support a fraud on the market claim, Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. Pa. L. Rev. 851, 899 (1992), there is no basis in logic or experience for such a requirement. To maintain a Rule 10b-5 action, a plaintiff must show only that he relied on the particular false statements at issue. Even if the plaintiff seeks to invoke the fraud on the market presumption, it should be unnecessary to demonstrate that the market is efficient as a *general* matter. Proving that a market is generally highly efficient, and thus tends to incorporate all information quickly, is unnecessary to demonstrating that there has been a fraud on the market as to a

specific statement. As long as a market functions well enough that the specific representation at issue was incorporated into a security's price, see Daniel R. Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 Cornell L. Rev. 907, 911 (1989), a showing of general efficiency is unnecessary. See Jonathan R. Macey et al., *Lessons from Financial Economics: Materiality, Reliance, and Extending the Reach of* Basic v. Levinson, 77 Va. L. Rev. 1017, 1021 (1991) ("Because security prices react quickly to new information, we can test for the relevant consideration—whether a security's price has been affected by misleading information."); Nathaniel Carden, Comment, *Implications of the Private Securities Litigation Reform Act of 1995 for Judicial Presumptions of Market Efficiency*, 65 U. Chi. L. Rev. 879, 904 (1998) (stating that "adherence to the [efficient capital markets hypothesis] is not critical for the fraud-on-the-market theory"). Perfect market efficiency may be "a sufficient reason why an investor relying on market-price integrity would be harmed" by fraud, but is not a necessary one "because fraud can and does distort prevailing prices" even in inefficient markets. Donald C. Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 161.

The fraud on the market theory effectively "shifts the inquiry from whether an individual investor was fooled to whether the market as a whole was fooled" by a particular misstatement. *In re Verifone Sec. Litig.*, 784 F. Supp. 1471, 1479 (N.D. Cal. 1992); see also Fischel, *Efficient Capital Markets, supra*, at 907. The efficient capital markets hypothesis, in contrast, provides a basis for the assumption that the market would be fooled by *any and all* instances of fraud.

But such a showing is unnecessary to demonstrate that the market was fooled as to a particular statement. As one scholar has observed, "[t]he only important question is whether the price was distorted," which requires only that the information was incorporated into the price of the individual stock, not that the market is efficient as a general matter. Langevoort, *Theories, supra*, at 898-99.

The understanding that perfectly efficient markets are unnecessary for application of the fraud on the market theory is borne out by the conception of that theory before *Basic*. The efficient capital markets hypothesis was first combined with the fraud on the market theory in the 1980s. See Jeffrey L. Oldham, Comment, *Taking "Efficient Markets" out of the Fraud-on-the-Market Doctrine after the Private Securities Litigation Reform Act*, 97 Nw. U. L. Rev. 995, 1006-11 (2003). Before that time, the fraud on the market presumption was described "as being predicated on a showing that 'the plaintiff establishes that a lie, misleading statement, or omission has affected the price of the stock.'" *Id.* at 1007 (quoting *Flamm* v. *Eberstadt*, 814 F.2d 1169, 1179 (7th Cir. 1987)); see also 4 Alan R. Bromberg & Lewis D. Lowenfels, Bromberg & Lowenfels on Securities Fraud and Commodities Fraud § 7:468 (2d ed. 2000) ("This text first suggested in 1967 that a 10b-5 reliance requirement in open market transactions could be satisfied by showing that an investor who traded with reference to market price and conditions could be treated as indirectly relying on a misrepresentation which affected the market."). Thus, the inquiry concerned the effect of a particular piece of information on the stock price in question.

But courts and commentators began to employ the efficient capital markets hypothesis, emphasizing that if a plaintiff could show that a market was efficient, then *any* material misrepresentation in a case necessarily affected the price of the security. Oldham, *supra*, at 1010-11 (citing *In re LTV Sec. Litig.*, 88 F.R.D. 134, 142-46 (N.D. Tex. 1980); Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 Bus. Law. 1, 9-10 (1982); Note, *The Fraud-on-the-Market Theory*, 95 Harv. L. Rev. 1143, 1154-56 (1982); Michael A. Lynn, Note, *Fraud on the Market: An Emerging Theory of Recovery Under SEC Rule 10b-5*, 50 Geo. Wash. L. Rev. 627, 647-53 (1982)); see also *Peil* v. *Speiser*, 806 F.2d 1154, 1163 (3d Cir. 1986) (stating that "a well-developed market can reasonably be presumed to respond to even a single material misrepresentation or omission concerning a stock * * * traded in that market"); Roger J. Dennis, *Materiality and the Efficient Capital Market Model: A Recipe for the Total Mix*, 25 Wm. & Mary L. Rev. 373, 374-75 (1984). *Basic* relied on several of these sources for its conclusion that well-developed markets reflect all public information. *Basic*, 485 U.S. at 246 n.24 (citing Dennis, Fischel, and *LTV*). Conversely, it was understood that if a market were *not* completely efficient, the fraud on the market presumption would be inappropriate. See *Reingold* v. *Deloitte Haskins & Sells*, 599 F. Supp. 1241, 1264 (S.D.N.Y. 1984) ("By contrast with efficient markets, inefficient markets by definition do not translate all available information into the price. In such markets, the price of a security does not necessarily reflect all [information and] an inference of * * * reliance is inapposite." (citation omitted)).

Thus, the efficient capital markets hypothesis "effectively became a proxy for showing that the misrepresentation actually affected the stock price." Oldham, *supra*, at 1011; accord Langevoort, *Theories*, *supra*, at 890-91 ("The fraud-on-the-market theory is often understood to carry with it the second presumption that in an efficient market, a material misrepresentation or actionable omission influences the market price, and therefore removes the need to actually prove the impact.").

The fact that total market efficiency is *unnecessary* to establish fraud on the market is not itself reason to eliminate the requirement of such a showing. But as noted below, reference to market efficiency has disadvantages that counsel the use of a different mechanism for demonstrating reliance.

B. *Basic*'s Efficiency Requirement Is Poorly Tailored to Remedy Fraud on the Market

Experience has shown that efficiency is not an especially close proxy for reliance, providing a remedy that is both underinclusive in some respects and overinclusive in others.

Basic's focus on the overall efficiency of a market, rather than the effect of the specific misstatement at issue, needlessly limits the ability of investors to employ the class-action mechanism with respect to fraud perpetrated in less efficient markets, even when the market price reflects those misstatements. Under prevailing caselaw in the lower courts, *Basic*'s presumption of reliance has been held to be unavailable to investors in newly issued securities, see *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 42 (2d Cir. 2006); *Freeman* v. *Laventhol &*

Horwath, 915 F.2d 193, 199 (6th Cir. 1990), mortgage-backed bonds, see *Teamsters Local 445 Freight Div. Pension Fund* v. *Bombardier Inc.*, 546 F.3d 196, 210 (2d Cir. 2008), collateralized debt obligations, see *Dodona I, LLC* v. *Goldman, Sachs & Co.*, -- F. Supp. 2d --, 2012 WL 935815, at *21 (S.D.N.Y. Mar. 21, 2012), and securities in less developed markets, see *Krogman* v. *Sterritt*, 202 F.R.D. 467, 474-78 (N.D. Tex. 2001), even when the false statement at issue is significant. A class-action remedy is frequently unavailable because the class cannot show efficiency.

This outcome is unfortunate because it is "in regard to the stock of small companies, traded over the counter or on non-traditional exchanges, that the kinds of fraud Rule 10b-5 was designed to avert are most likely to occur." Geoffrey Christopher Rapp, *Proving Markets Inefficient: The Variability of Federal Court Decisions on Market Efficiency in* Cammer v. Bloom *and its Progeny*, 10 U. Miami Bus. L. Rev 303, 322-23 (2002); see also Advisory Comm. on Smaller Public Companies, Final Report to the U.S. Securities & Exchange Commission 139 (2006) (2006), *available at* http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf (noting that "small firms consistently have more misstatements and restatements of financial information, nearly twice the rate of large firms"). If the rationale for fraud on the market is that investors should be able to rely on securities markets being free from fraud, as the Ninth Circuit has observed,[3] it makes little sense to

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[3] See *Blackie* v. *Barrack*, 524 F.2d 891, 907 (9th Cir. 1975) ("The statute and rule [of Section 10(b) and Rule 10b-5] are designed to foster an expectation that securities markets are

focus on market efficiency, which effectively limits the presumption of reliance to only the largest and most trustworthy securities issuers.

Just as the emphasis on efficiency is underinclusive as to strong fraud cases perpetrated in less efficient markets, it is overinclusive, as a practical matter, as to weak fraud cases involving more efficient markets. "For large-cap stocks, there is seldom any debate over whether the market is efficient enough: efficiency is assumed." Langevoort, Basic *at Twenty*, *supra*, at 173. Thus, plaintiffs suing a widely traded issuer can be certified as a class even in cases where the market, due to the obscurity or complexity of the information (or some other reason), did not actually rely on the misstatements. Although defendants can assert a lack of actual reliance as a defense on the merits, as a practical matter, a class action is overwhelmingly likely to settle once it is certified.[4] Because such settlements are most easily

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free from fraud—an expectation on which purchasers should be able to rely.").

[4] See Jordan Milev et al., *Recent Trends in Securities Class Action Litigation: 2011 Year-End Review* 12 (Dec. 14, 2011) (unpublished manuscript), *available at* www.nera.com/nera-files/PUB_Trends_Year-End_1211_final.pdf (noting that since late 1995, "there have been only 29 securities class action trials, as compared to a total number of over 3,800 filings"); Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 99 (2009) (observing that class certification usually "sets the litigation on a path toward resolution by way of settlement"); Bruce H. Kobayashi & Larry E. Ribstein, *Class Action Lawyers as Lawmakers*, 46 Ariz. L. Rev. 733, 743 (2004) (stating that "many certified class actions settle quickly"); Bryant G. Garth, *Studying Civil Litigation Through the Class Action*, 62 Ind. L.J. 497, 501 (1987) (reporting a 78% settlement

procured from the largest and most well-traded companies (which have the most to lose and can more readily afford them), they create a significant impact on the capital markets. Such an overinclusive standard is counterproductive.

C. Market Efficiency Determinations Are Difficult for Courts to Make

Many courts interpret *Basic* to permit plaintiffs, upon a showing of efficiency, to substitute a rebuttable presumption of reliance for a showing that the alleged misrepresentations at issue actually influenced the market price. This substitution suggests both that the efficient capital markets hypothesis is a sound explanation for market movements and that evaluating a security's overall efficiency is more practicable than determining whether the misstatement at issue actually distorted the market price. See *Litton Indus., Inc.* v. *Lehman Bros. Kuhn Loeb Inc.*, 967 F.2d 742, 748 (2d Cir. 1992) ("To saddle a plaintiff with proving the 'generally indeterminable fact of what would have happened but for * * * the misrepresentations that skewed the market value of stock would reduce the protection against fraud afforded by Section 10(b).'" (brackets omitted) (quoting *duPont* v. *Brady*, 828 F.2d 75, 78 (2d Cir. 1987))). But it is now recognized that markets are rarely, if ever, totally efficient, and showing efficiency is in most cases a more difficult task than demonstrating distortion of market price caused by a particular misstatement.

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rate for certified class actions and only a 15% settlement rate for noncertified cases).

1. Since *Basic* Was Decided, Research Has Called the Efficiency of Markets into Question

In employing the efficient capital markets hypothesis to support a presumption of reliance, *Basic* observed that "empirical studies have tended to confirm * * * that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." 485 U.S. at 246. The decision thus relied on the understanding that "[r]esearchers agree that the efficient capital market model," which "posits that the price of a security reflects all publicly available information[,] * * * accurately represents the pricing behavior of stocks." Dennis, *supra*, at 374-75; see *Basic*, 485 U.S. at 246 n.24 (citing Dennis). On that basis, courts and commentators have concluded that *Basic* implicitly endorsed the semi-strong form of the efficient capital markets hypothesis, which theorizes that "an efficient market is one in which all publicly available information is reflected in the market price of the stock." *PolyMedica*, 432 F.3d at 10 n.16; see also *Schleicher* v. *Wendt*, 618 F.3d 679, 685 (7th Cir. 2010).

The *Basic* Court's confidence in the efficient capital markets hypothesis was a product of its time. See Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. Corp. L. 635, 635 (2003) (noting that, by the 1980s, the efficient capital markets hypothesis "became one of the most widely-accepted and influential ideas in finance economics"); Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev. 549, 549 (1984) ("Of all recent

developments in financial economics, the efficient capital markets hypothesis * * * has achieved the widest acceptance by the legal culture.") However, as economists' understanding of capital markets has deepened, they have tempered their faith in the efficiency that was thought to be so prevalent in *Basic*'s day.

Contrary to the view of efficiency *Basic* appears to have accepted—and which respondent asserts[5]—"efficiency is not a binary, yes or no question." Langevoort, Basic *at Twenty*, *supra*, at 167. Rather, there is a spectrum of market efficiency, see Gilson & Kraakman, *supra*, at 560, and "[p]erfect efficiency is just a theoretical ideal," Langevoort, Basic *at Twenty*, *supra*, at 167. Levels of efficiency even vary among types of information concerning the same market: If one piece of information is more easily collected and understood than another, it will make its way into the market price more quickly, even if both pieces of information concern the same security. See Brad M. Barber et al., *The Fraud-on-the-Market Theory and the Indicators of Common Stocks' Efficiency*, 19 J. Corp. L. 285, 290-91 (1994); Gilson & Kraakman, *supra*, at 558-59.[6] "For example, stock

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[5] See Brief in Opposition at 10 ("[I]f public statements are made in an efficient market, the materiality of the statements affects all purchasers similarly.").

[6] See also Stout, *supra*, at 656:

> Information that is easy to understand and that is trumpeted in the business media—for example, merger announcements or news of a stock split—may be incorporated into market prices almost instantaneously. But information that is "public" but difficult to get hold of, or information that is complex or requires a specialist's knowledge to comprehend, may take weeks

prices may reflect certain types of public information (concerning, for instance its own prices, or the interest rate on Treasury Bills) faster than other types of public information (concerning, for example, Iraq's invasion of Kuwait)." Ian Ayres, *Back to Basics: Regulating How Corporations Speak to the Market*, 77 Va. L. Rev. 945, 976 (1991).

And because no real-world market is completely efficient, information—even important, publicly disseminated information—is not always rapidly incorporated into prices. For example, there is evidence of large disparities in market reaction to accounting restatements as a result of the prominence of the restatements. See Rebecca Files et al., *Stealth Disclosure of Accounting Restatements* (Apr. 27, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1395768. Similarly, there is evidence that the *Wall Street Journal*'s publication of reports of trading by corporate insiders rapidly and significantly affects that corporation's stock price, even though the SEC usually makes such reports public several days earlier. See Saeyoung Chang & David Y. Suk, *Stock Prices and the Secondary Dissemination of Information: The Wall Street Journal's "Insider Trading Spotlight" Column*, 33 Fin. Rev. 115, 115-17 (1998). And "[o]ne of the most common types of material disclosures—an earnings surprise—actually takes a while to be fully impounded, even for large-cap stocks, and even varies depending on whether it is good news or bad." Langevoort, Basic *at Twenty*, *supra*, at 170. The efficient capital markets hypothesis would suggest

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or months to be fully incorporated into prices. Indeed it may never be fully incorporated at all.

that such material, public information would be quickly incorporated into stock prices, but empirical evidence indicates otherwise.

In the same vein, in *In re Merck & Co. Securities Litigation*, 432 F.3d 261 (3d Cir. 2005), information regarding Merck—a large and well-followed firm in a well-developed market—was first released to the public in a complicated format through an SEC filing, to no demonstrable market effect. *Id.* at 269-70. As one scholar has noted, "it is hard to imagine any stock more likely traded in an efficient market than Merck," Langevoort, Basic *at Twenty*, *supra*, at 174, and so the efficient capital markets hypothesis would suggest that this information would rapidly be incorporated in price. But when an article in the *Wall Street Journal* "read[] between the lines of this disclosure" several weeks later, the result was a significant decline in price. *Merck*, 432 F.3d at 263, 265. The court of appeals determined on this basis that the information was immaterial—even though the markets' response to the *Journal* article clearly militates against that conclusion—because "the efficient market hypothesis suggests that the market made these basic calculations months earlier." *Id.* at 271. But also plausible is the possibility that the market had not actually incorporated the information when first released in the more obscure format. See, *e.g.*, Langevoort, Basic *at Twenty*, *supra*, at 176 (noting possibility that market missed implications of Merck's initial disclosures). Commentators have

identified many other instances in which markets have moved inefficiently.[7]

Early research on the efficient capital markets hypothesis—the kind of research available at the time *Basic* was decided—focused on types of information that are usually rapidly incorporated into market prices (such as "stock splits, dividend changes, corporate mergers, and the like"). Stout, *supra*, at 653. But other "types of information highly relevant to assessing the economic health of firms appear to be incorporated into stock prices far more slowly and incompletely than the conventional view of market efficiency would suggest." *Id.* Researchers also analyzed broad-based indices rather than individual securities, which brought about results showing efficiency and obscured anomalous results involving particular securities. See Frederick C.

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[7] See, *e.g.*, Langevoort, Basic *at Twenty*, *supra*, at 175 (stating that "the contemporary literature suggests that even for widely traded stocks, substantial deviations from the efficiency ideal are quite possible"); Marlene A. Plumlee, *The Effect of Information Complexity on Analysts' Use of That Information*, 78 Acct. Rev. 275, 293 (2003) (concluding that analysts fail to incorporate complex information in forecasts); Gur Huberman & Tomer Regev, *Contagious Speculation and a Cure for Cancer: A Nonevent that Made Stock Prices Soar*, 56 J. Fin. 387 (2001) (noting significant market effect of prominent news item concerning information that had been public for months); Peter Klibanoff et al., *Investor Reaction to Salient News in Closed-End Country Funds*, 53 J. Fin. 673 (1998) (concluding that well-publicized news items were more likely to move the market than redundant information found elsewhere, and that well-publicized news events created short periods in which the relevant markets reacted more quickly to changes); Thomas S.Y. Ho & Roni Michaely, *Information Quality and Market Efficiency*, 23 J. Fin. & Quantitative Analysis 53 (1988) (finding market effect from republication of already available information).

Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 Del. J. Corp. L. 455, 525 (2006).

Post-*Basic* research reveals significant limitations on the efficient capital markets hypothesis. This is not to say that markets never rapidly incorporate most public information. But exceptions to the hypothesis exist, even as to material information in relatively efficient markets. In light of this research, *Basic*'s assumption that a market deemed efficient will promptly and reliably reflect a *particular misstatement* into a security's price—which is, at bottom, what courts consider to be a "fraud on the market"[8]—is no longer consistently accurate.

2. Courts and Commentators Have Struggled with Determining When a Particular Market Is Sufficiently "Efficient" to Support a Presumption of Reliance

Basic requires courts to determine whether markets are "efficient" or "not efficient." But that is easier said than done. As seen above, markets exist along a spectrum of efficiency rather than at either end, and *Basic* offers no guidance about the point at which a market becomes efficient enough to qualify for the presumption of reliance. Moreover, the determination of efficiency is inherently difficult to make. Not even financial economists have been able to develop an agreed-upon test to prove efficiency.

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[8] See *Verifone*, 784 F. Supp. at 1479 ("The fraud-on-the-market theory * * * shifts the inquiry from whether an individual investor was fooled to whether the market as a whole was fooled.").

Because economists "do not know how to []calculate the price that fully reflects the available information," it is difficult at best to test whether a market fully reflects all publicly available information. Alon Brav & J.B. Heaton, *Market Indeterminacy*, 28 J. Corp. L. 517, 525 (2003); Fama, *supra*, at 1575 ("[M]arket efficiency per se is not testable."). Perfect efficiency is not a realistic scenario. See Fama, *supra*, at 1575.

If efficiency determinations are difficult (if not impossible) for economists, they are harder still for courts: Determining efficiency "requires courts to drift far from their institutional competence." Carden, *supra*, at 905. Because of difficulties in determining market efficiency, courts have resorted to examining proxies associated with efficient markets. If the proxies indicate a sufficiently large and developed market, the market is deemed efficient. The most prominent of the tests developed by the courts is that set forth in *Cammer* v. *Bloom*, 711 F. Supp. 1264 (D.N.J. 1989). The proxies examined by *Cammer* were the percentage of shares traded weekly; whether "a significant number" of analysts follow and report on the stock; the existence of market makers trading the stock; whether the issuer was qualified to use an S-3 registration statement with the SEC; and whether the plaintiff can "allege empirical facts showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock price." *Id.* at 1286-87. Courts have also looked to other proxies, including market capitalization, see *Krogman*, 202 F.R.D. at 478, bid-ask spread, *id.*, percentage of stock held by insiders, *id.*, and volume of trading by institutional investors, *O'Neil* v. *Appel*,

165 F.R.D. 479, 503 (W.D. Mich. 1996). But these indicators are only proxies for efficiency. See *In re Countrywide Fin. Corp. Sec. Litig.*, 273 F.R.D. 586, 613 (C.D. Cal. 2009) (stating that many *Cammer* factors "indirectly assess market efficiency"); Bradford Cornell & James C. Rutten, *Market Efficiency, Crashes, and Securities Litigation*, 81 Tul. L. Rev. 443, 455 (2006) ("Inasmuch as the *Cammer* and *Krogman* factors for the most part do not directly speak to efficiency, but instead speak to whether a market is 'open and developed,' they are best understood as constituting an indirect test by which courts infer efficiency for reliance purposes."). These courts, then, took *Basic*'s already-relaxed concept of reliance—essentially a proxy for individual reliance adopted to allow more plaintiffs to bring securities class actions—and relaxed it further by allowing proxies for efficiency rather than the inquiry into actual efficiency *Basic* required.

What is more, the factors lower courts consider in determining efficiency frequently are unmoored from efficiency. Apart from being highly correlated with each other (and therefore redundant),[9] research indicates that some often-considered factors thought to be proxies for efficiency, such as the number of market makers, issuer size, bid-ask spread, and institutional holdings, are not empirically correlated with efficiency. See Barber et al., *supra*, at 285-86; Victor L. Bernard et al., *Challenges to the Efficient Market Hypothesis: Limits to the Applicability of*

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[9] Barber et al., *supra*, at 293 ("[G]iven that most efficiency drivers are correlated, as the volume of trade and firm size are, they cannot be considered as independent efficiency indicators.").

Fraud-on-the-Market Theory, 73 Neb. L. Rev. 781, 796 (1994). As a result of this research, some courts have reduced the emphasis on market makers. See, *e.g.*, *Unger* v. *Amedisys Inc.*, 401 F.3d 316, 324 (5th Cir. 2005). But even these courts persist in considering other less reliable factors, and many other courts continue to use all the *Cammer* factors. See, *e.g.*, *In re Dynex Capital, Inc. Sec. Litig.*, No. 05 Civ. 1897, 2011 WL 781215, at *5 (S.D.N.Y. Mar. 7, 2011) (examining market makers); *In re HealthSouth Corp. Sec. Litig.*, 261 F.R.D. 616, 635 (N.D. Ala. 2009); *In re Infineon Techs. AG Sec. Litig.*, 266 F.R.D. 386, 396-97 (N.D. Cal. 2009). And even the *Cammer* factor most closely correlated with efficiency—the speed at which the stock incorporated other information in the past—may not say much about how quickly the market incorporated the information at issue in a particular case, because different types of information, and information disclosed through different sources, are incorporated at different rates.

This problem is compounded by the fact that many proxies closely correlated with efficiency do not actually test efficiency. See David Tabak, *Use and Misuse of Event Studies to Examine Market Efficiency* 2 (Apr. 30, 2010) (unpublished manuscript), *available at* www.nera.com/nera-files/PUB_Use_Misuse_of_Event_Studies_0410_final.pdf) (noting that, with the exception of response of prices to new information, "factors cited by courts are designed to be conditions that are likely to either be conducive to or the result of an efficient market"). Thus, their correlation with efficiency may be diminished in the future. For example, the studies noted above, which indicate that dollar trading volume is indicative of efficiency, were published in 1994. Since then, internet trading has

risen in popularity, increasing the number of novice investors and adding to overall trading volume.[10] This added volume does not mean that the market became more efficient—in fact, internet traders and day traders often add to stock volatility without causing the stock price to reflect available information any more quickly. See William O. Fisher, *Does the Efficient Market Theory Help Us Do Justice in a Time of Madness?*, 54 Emory L.J. 843, 930 (2005) (noting that "large trading volume does not—if significantly including day trading and other online retail brokerage transactions—signal that the mechanism for efficient market pricing is actively working on the stock price"). Thus, trading volume probably is not as closely correlated with efficiency now as it was in 1994.

The relationship between analyst following and efficiency has been questioned in light of a similar change in market circumstances. See *id.* at 966-68 (noting that analyst bias during the dot-com bubble of 1998-2001 rendered analyst following an unsound predictor of efficiency during that period). More broadly, because most of the *Cammer* factors "are largely *descriptive*, not *predictive*," and cannot "be used directly to predict efficiency," Rapp, *supra*, at 319, there is always a risk that changes such as the internet trading explosion will confound the factors'

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[10] See Brad M. Barber & Terrance Odean, *The Internet and the Investor*, 15 J. Econ. Persp. 41, 41, 47 (2001) (stating that "[f]rom 1995 through mid-2000, investors opened 12.5 million on-line brokerage accounts" and that evidence suggests that access to internet trading leads to a greater volume of trading); Gregory La Blanc & Jeffrey J. Rachlinski, *In Praise of Investor Irrationality*, *in* The Law and Economics of Irrational Behavior 542, 558-59 (Francesco Parisi & Vernon L. Smith eds. 2005).

correlative strength. Because there inevitably will be lag time in understanding changes in the securities market, when such changes occur, courts may not apprehend their significance for years. Thus, courts' tests for efficiency may include factors that do not accurately reflect the operation of the market.

In addition, courts consider these factors in inconsistent ways. The caselaw is unclear about how much of a factor is necessary to show efficiency, or whether a combination of factors is required. Courts are "ill-equipped to determine and analyze the fundamentals of market efficiency; *i.e.*, * * * 'how many' analysts [a]re needed to ensure that information concerning a company finds its way, through buy and sell recommendations, into the price of a company's stock, and 'how many' market makers [a]re needed to ensure the market's 'swift' incorporation of company news into the price of a company's stock." Paul A. Ferillo et al., *The "Less Than" Efficient Capital Markets Hypothesis: Requiring More Proof from Plaintiffs in Fraud-on-the-Market Cases*, 78 St. John's L. Rev. 81, 93 (2004) (citations omitted). Thus, courts applying *Cammer* factors have come to disparate conclusions when evaluating similar facts. See Rapp, *supra*, at 309-317, 328. The result is "a massive hodgepodge of * * * outcomes." Ferillo, *supra*, at 102 (reviewing cases and concluding "most courts will come to very individual conclusions" on efficiency and find different factors persuasive).

In view of the difficulties courts face in determining the efficiency of markets, this Court should reconsider the role *Basic* has assigned to the

efficiency determination in assessing reliance. As one scholar has observed:

> Given the well-acknowledged practical and conceptual difficulties of determining what is or is not a truly efficient market—various conundra that all stem from treating efficiency as a yes/no question rather than one that varies as a matter of degree depending on the type of issuer and the type of information—there are good reasons to want to avoid this sort of threshold inquiry.

Langevoort, *Theories*, *supra*, at 898-99. As set forth below, this Court should abandon *Basic*'s insistence upon a showing of efficiency in favor of a showing that the particular misrepresentation caused a market distortion.

II. IN DETERMINING RELIANCE, COURTS SHOULD LOOK TO MARKET MOVEMENT CAUSED BY AN ALLEGED MISREPRESENTATION, RATHER THAN TO OVERALL MARKET EFFICIENCY

Judicial inquiry into market efficiency, despite its difficulties, might still be worthwhile if it were the most reliable means of establishing whether to apply the fraud on the market presumption. But it is not. Apart from the fact that courts have difficulty making determinations of efficiency, see *supra* at 20-26, ultimately, proving the efficiency of the market as a whole is only an indirect means of proving that the market relied on a particular statement. And as discussed below, determining whether a particular misstatement distorted the market is typically *easier* than demonstrating efficiency of the market as a

whole. It is also a more direct means of inquiring into reliance, and a more reliable method of showing whether the complained-of fraud was, in fact, a "fraud on the market."

A. The Event Study Is the Best Available Tool to Examine Market Distortion and Show Reliance

The central issue in determining whether the fraud on the market presumption may be invoked is "whether the challenged disclosure artificially inflated ([or] deflated) the market price of the particular security. Inquiry into whether the market price was inflated ([or] deflated) replaces individualized inquiry into the extent to which particular investors were aware of a challenged disclosure." Fischel, *Efficient Capital Markets*, *supra*, at 908. But even without relying on the general efficiency of markets, there remains a reliable and practicable method for courts to determine whether misstatements distorted the market: the event study.

"An event study is a regression analysis that measures the effect of an event, such as a firm's earnings announcement, on a firm's stock price." Allen Ferrell & Atanu Saha, *The Loss Causation Requirement for Rule 10b-5 Causes of Action: The Implications of* Dura Pharmaceuticals, Inc. v. Broudo, 63 Bus. Law. 163, 166 (2007). "[A]n event study [can] determine whether the alleged misrepresentations caused any statistically significant stock price movements when made or when a supposedly corrective disclosure was made, controlling for other possible causes of stock price movements (such as movements of the overall market) and random

fluctuations." Daniel R. Fischel, *Market Evidence in Corporate Law*, 69 U. Chi. L. Rev. 941, 948 (2002). They "are commonly used to isolate the effects on the stock price of the disclosure of the withheld information." Janet Cooper Alexander, *The Value of Bad News in Securities Class Actions*, 41 UCLA L. Rev. 1421, 1433 (1994). Thus,

> [i]f an event study shows that a misrepresentation or a corrective disclosure had a statistically significant effect on the price of a stock, then the market may be said to have 'relied' on the misrepresentation. And, by the fraud-on-the-market theory, all of the investors who bought (or sold) the stock also 'relied' by buying or selling at a market price that included a component reflecting the falsity.

Fisher, *supra*, at 874. Conversely, if an event study shows that a misrepresentation or corrective disclosure[11] had no statistically significant effect on the stock price, then the market cannot be said to have relied on the misrepresentation.

The event study is the "gold standard" technique for determining whether the market for a security

---

[11] When the fraud at issue involves an alleged omission or a misstatement to meet expectations (and accordingly has no effect on stock price), plaintiffs can use an event study to discern the market effect of the corrective disclosure. See David Tabak, *Loss Causation and Damages in Shareholder Class Actions: When It Takes Two Steps to Tango* 6 (May 27, 2004) (unpublished manuscript), *available at* http://www.nera.com/extImage/200405Tabak_Loss_Causation.pdf. However, *amici* do not contend that the presumption of reliance in cases of pure omissions created by *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972), should be disturbed.

relied on a misstatement. Madge S. Thorsen et al., *Rediscovering the Economics of Loss Causation*, 6 J. Bus. & Sec. L. 93, 109 (2006). It is accepted by courts, academics, and the SEC for that purpose. See *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 245 F.R.D. 147, 170 (S.D.N.Y. 2007), *rev'd on other grounds*, 574 F.3d 29 (2d Cir. 2009) (finding "numerous courts have held that an event study is a reliable method for determining market efficiency"); *In re N. Telecom Ltd. Sec. Litig.*, 116 F. Supp. 2d 446, 460 (S.D.N.Y. 2000); *In re Oracle Sec. Litig.*, 829 F. Supp. 1176, 1181 (N.D. Cal. 1993); Fischel, *Market Evidence*, *supra*, at 948 (describing an event study as a "simple statistical technique, used in thousands of academic studies and employed routinely in securities fraud litigation brought under the federal securities laws"); Mark L. Mitchell & Jeffry M. Netter, *The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission*, 49 Bus. Law. 545, 572-84 (1994) (describing SEC enforcement actions using event study analysis).

Event studies are routinely employed to show that a market is efficient at the class certification stage. See, *e.g.*, *Teamsters*, 546 F.3d at 207-10; *In re Xcelera.com Sec. Litig.*, 430 F.3d 503, 512-14 (1st Cir. 2005); *In re Nature's Sunshine Prods. Inc. Sec. Litig.*, 251 F.R.D. 656, 664-65 (D. Utah 2008). Such studies examine the market effect of various news items relating to an issuer; if the security "change[s] rapidly, and in the expected direction, in response to new information," it supports a finding of market efficiency. *Schleicher*, 618 F.3d at 684; *Teamsters*, 546 F.3d at 207-08 ("Evidence that unexpected corporate events or financial releases cause an

immediate response in the price of a security has been considered 'the most important [] *Cammer* factor.'" (quoting *Xcelera.com*, 430 F.3d at 512)).

Thus, courts are already requesting, and plaintiffs are already providing, experts' event studies examining the effect of disclosures at the class certification stage to prove that a market generally incorporates information into prices, to trigger the *Basic* presumption of reliance. But the same experts could conduct the same analyses to determine directly whether the alleged misstatement was incorporated into the stock price—the added step of determining efficiency as a general matter is unnecessary. Event studies can examine market effects of particular affirmative misstatements by looking to the effect at the time of disclosure; in cases involving omissions, they can look to the date the information was corrected. See David Tabak, *Making Assessments about Materiality Less Subjective Through the Use of Content Analysis* 4-5 (Mar. 13, 2007) (unpublished manuscript), *available at* http://www.nera.com/extImage/PUB_Tabak_Content_Analysis_SEC1646-FINAL.pdf.

Amici professors submit that a direct analysis of the market impact of a specific alleged misstatement, rather than examination of general market efficiency, is a more straightforward and reliable test for whether the fraud on the market theory should be invoked. Such an approach conforms *Basic* to current finance theory and research, and by limiting the over- and underinclusiveness of the current approach, it offers a better balance between allowing meritorious class actions and preventing baseless ones at the outset.

In a recent case involving similar issues, it was argued that it is difficult to disentangle multiple simultaneous disclosures using an event study. See Brief for Law Professors as *Amici Curiae* Supporting Petitioner at 28-29, *Erica P. John Fund, Inc.* v. *Halliburton*, 131 S. Ct. 2179 (No. 09-1403) [hereinafter Professors' *Halliburton Amicus* Br.]. But while it may be more difficult in such instances to show price distortion as a result of a particular misstatement, there is no reason to think it is beyond the capability of event studies. See Frederick C. Dunbar & Arun Sen, *Counterfactual Keys to Causation and Damages in Shareholder Class Action Lawsuits*, 2009 Wis. L. Rev. 199, 227-41 (noting that content analysis can separate and clarify the impact of multiple simultaneous events); Ferrell & Saha, *supra*, at 170 (explaining the use of shorter event windows to avoid confounding events); David I. Tabak & Frederick C. Dunbar, *Materiality and Magnitude: Event Studies in the Courtroom*, *in* Litigation Services Handbook 19.2 (Roman L. Weil et al. eds., 2001) (noting that economists can disentangle the effects of multiple announcements on a single day if the effect of nonfraudulent announcements on that day can be estimated, perhaps through analogues on other days). Any claim that event studies of simultaneous information disclosures are too difficult would ring hollow in light of the fact that such studies would are routinely called for and used to demonstrate loss causation or materiality on the merits.

It was also suggested by *amici* in *Halliburton* that requiring event studies at the class certification stage is inappropriate because they may require evidence obtainable only through discovery. See Professors'

Halliburton Amicus Br. at 28-29; Brief of Financial Economists as *Amici Curiae* Supporting Petitioner at 31-33, *Erica P. John Fund, Inc.* v. *Halliburton*, 131 S. Ct. 2179 (No. 09-1403). But these *amici* together identified only one purported example of information useful for conducting an event study that would be obtainable only through discovery — the identity of competing or peer firms. Professors' *Halliburton Amicus* Br. at 28-29 (citing Jonathan Klick & Robert H. Sitkoff, *Agency Costs, Charitable Trusts, and Corporate Control: Evidence from Hershey's Kiss-Off*, 108 Colum. L. Rev. 749, 806-14 (2008), to illustrate the use of competitor information in an event study). Now, as then, that argument misses the mark. The very research *amici* professors cite as illustrative used publicly available data to determine relevant competitors. See Klick & Sitkoff, *supra*, at 793 & nn.250-51 ("We took our roster of Hershey's chocolate rivals from Google Finance * * * and Yahoo! Finance."). And because event studies examine *publicly* disseminated information and its effect on *public* markets, the role of undisclosed *private* information is negligible. In any event, courts routinely call for discovery at the class certification stage. See, *e.g.*, *Initial Public Offerings Sec. Litig.*, 471 F.3d at 39 n.10.

B. Because the Proposed Class Has the Burden of Persuasion on Class Certification Under Rule 23, It Should Have to Show That the Alleged Misrepresentation Caused Market Distortion at the Class Certification Stage

"In addition to satisfying Rule 23(a)'s prerequisites, parties seeking class certification must show that the action is maintainable under Rule

23(b)(1), (2), or (3)." *Amchem Prods., Inc.* v. *Windsor*, 521 U.S. 591, 614 (1997). Thus, when plaintiffs wish to file a class action under Rule 23(b)(3), it is their burden to show that common questions "predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). In the context of Rule 10b-5 class actions, it follows that it is plaintiffs' burden to show that common questions of reliance predominate over reliance questions affecting individual class members. Demonstrating applicability of the fraud on the market presumption is therefore plaintiffs' burden. See *Erica P. John Fund*, 131 S. Ct. at 2185 (stating that "securities fraud plaintiffs must prove certain things," such as efficiency and the public nature of the statements at issue, "in order to invoke *Basic*'s rebuttable presumption of reliance"); *Salomon*, 544 F.3d at 485 (discussing whether "plaintiffs had met their burden for invoking the fraud-on-the-market presumption"). This showing must be made before certification. See *Szabo* v. *Bridgeport Machs., Inc.*, 249 F.3d 672, 676 (7th Cir. 2001). Therefore, just as plaintiffs are required to demonstrate market "efficiency" at the class certification stage, see, *e.g.*, *Gariety*, 368 F.3d at 368, so should they be required to show market distortion to invoke the fraud on the market presumption.

Amici do not suggest that plaintiffs be subjected to a "preliminary inquiry into the merits of a suit." *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974). Rather, because the fraud on the market presumption must be invoked at the class certification stage, it is "necessary for the court to probe behind the pleadings before coming to rest on the certification question." *Gen. Tel. Co.* v. *Falcon*,

457 U.S. 147, 160 (1982). The Court recently reaffirmed this proposition. See *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541, 2551 (2011) ("A party seeking class certification must affirmatively demonstrate his compliance with [Rule 23]—that is, he must be prepared to prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc. * * * Frequently that [process] will entail some overlap with the merits of the plaintiff's underlying claim. That cannot be helped."); see also *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 469 (1978) ("[T]he class determination generally involves considerations that are enmeshed in the factual and legal issues comprising the plaintiff's cause of action.") (internal quotation marks omitted). As the Second Circuit has observed, *Eisen* is "properly understood to preclude consideration of the merits only when a merits issue is unrelated to a Rule 23 requirement." *Initial Public Offerings Sec. Litig.*, 471 F.3d at 41. Accordingly, "there is no reason to lessen a district court's obligation to make a determination that every Rule 23 requirement is met before certifying a class just because of some or even full overlap of that requirement with a merits issue." *Id.*; accord *Love* v. *Turlington*, 733 F.2d 1562, 1564 (11th Cir. 1984) ("While it is true that a trial court may not properly reach the merits of a claim when determining whether class certification is warranted, this principle should not be talismanically invoked to artificially limit a trial court's examination of the factors necessary to a reasoned determination of whether a plaintiff has met her burden of establishing each of the Rule 23 class action requirements."). Such is the case here.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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AMICUS CURIAE BRIEF

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v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF *AMICUS CURIAE* OF NATIONAL ASSOCIATION OF SHAREHOLDER AND CONSUMER ATTORNEYS IN SUPPORT OF RESPONDENT

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INTEREST OF AMICUS CURIAE[1]

The National Association of Shareholder and Consumer Attorneys ("NASCAT") is a trade organization and public policy voice for lawyers interested in a strong system of legal protections for investors and consumers. NASCAT and its members are committed to representing victims of corporate abuse, fraud, and white collar crime in cases having the potential to advance the state of the law, educate the public, modify corporate behavior, and improve access to justice and compensation for those who have been injured by corporate wrongdoers.

NASCAT has a deeply-rooted interest in the issue this case presents: whether securities plaintiffs attempting to invoke a presumption of reliance premised on the fraud-on-the-market doctrine must demonstrate materiality at the class certification stage. NASCAT agrees with Respondent's arguments against such a requirement, and writes separately to address the serious practical difficulties inherent in Amgen's position.

SUMMARY OF ARGUMENT

There are many different kinds of issues that arise when one examines the materiality of a misstatement or omission. For example, even small errors may be critical if they concern an important area of the business.

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1. Pursuant to Rule 37.6, amicus affirms that no counsel for a party authored this brief in whole or in part, and that no person other than amicus and its counsel made a monetary contribution to the preparation or submission of this brief. The parties have filed letters giving blanket consent to the filing of amicus briefs in this case.

Investors may expect, and discount, a certain amount of sales puffery; but they may also highly value the opinions and judgments of management. Contingent events may be of greater or lesser importance depending on both their likelihood and their potential impact on the business. These questions are all part of the materiality inquiry, and in many cases they cannot be answered prior to the completion of both fact and expert discovery. This is particularly true for class actions, where there are usually multiple false statements and material omissions that continue over a prolonged period.

This is not to say that defendants have no meaningful opportunity to contest materiality before the completion of discovery. In fact, courts commonly dismiss claims under Rule 12(b)(6) on materiality grounds, frequently taking judicial notice of materials outside the complaint to evaluate the materiality of an alleged misstatement or omission in its full context. However, this means that for complaints that survive a motion to dismiss, the only remaining materiality questions are the ones that, by definition, require a full record to evaluate properly.

For this reason, requiring an assessment of materiality at class certification would dramatically extend proceedings that are already quite prolonged, thus wasting judicial resources and forcing the parties to bear unnecessary expenses. Section 10(b) actions in particular take a long time to advance past the motion to dismiss; it may be years before discovery begins, and additional years before class certification is decided. Introducing materiality into the mix would delay resolution of class certification even further, creating additional inefficiencies.

Nor can these problems be solved by using "price impact" as a proxy for materiality. Most defendants commit fraud to conceal "bad news." These frauds do not result in a measurable "uptick" in stock price; instead, they keep prices level when the truth would have caused them to fall. Thus, the only measurable price impact occurs when the truth concealed by the fraud is fully or partially disclosed. But an inquiry into the price effects of disclosures is indistinguishable from an assessment of *loss causation* (and Amgen and its amici do not argue otherwise). This Court has already recognized that plaintiffs need not prove loss causation to satisfy the requirements of Rule 23. *See Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011).

The problems with assessing materiality at class certification are illustrated by the very cases cited by Amgen's *amici* as examples of how the inquiry could proceed. In several of these cases, the district courts dramatically misinterpreted the stock price evidence on which they purported to rely, reaching conclusions that are fundamentally at odds with basic principles of economics. In others, the courts dealt with unusually simple records, or went with their own "common sense" – an inquiry facially more suited for a jury determination.

Finally, it is not necessary to prove materiality at class certification to protect defendants from "blackmail settlements." In the PSLRA, Congress instituted several measures to curb abusive lawsuits and reduce such pressures. The evidence shows that defendants are not being coerced into settling meritless lawsuits, and that securities class action litigation serves a valuable tool

for improving corporate governance and strengthening financial markets.

ARGUMENT

I. MATERIALITY IS A COMPLEX QUESTION THAT USUALLY REQUIRES A FULL RECORD FOR ACCURATE RESOLUTION

A fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). By definition, materiality is fact-specific and context-dependent, requiring "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences." *Id.* at 236 (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U. S. 438, 450 (1976)). Nor is precedent a clear guide because "[m]ateriality determinations in individual cases tend to be so fact-specific that the accumulated body of published case law provides limited guidance for decision-making." Richard C. Sauer, *The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws*, 62 Bus. Law. 317, 319 (2007) (quotations omitted). Even stock price reaction to a disclosure, though *evidence* of materiality, is not dispositive: facts may be immaterial even if their disclosure causes a large price drop. *See, e.g.*, *Greenhouse v. MCG Capital Corp.*, 392 F.3d 650, 655 (4th Cir. 2004).

For example, there may be a dispute about whether an omitted fact concerns such a small matter that it is

immaterial. In such cases, the factfinder must identify the proper basis for comparison: should materiality be assessed against the relevant operating segment of a diversified company, or against the corporation as a whole? *See, e.g., Litwin v. Blackstone Group, L.P.*, 634 F.3d 706, 713 (2d Cir. 2011). And what if the fact relates to a small but rapidly growing business line? Some metrics, such as revenue, may be more significant for new companies than for established ones – and others (*e.g.* cashflow) may be more or less important depending on the company's overall capitalization. *See* Sauer, *supra*, at 321. Such delicate judgments require a full examination of the facts.

Some corporate statements concern not "hard" facts, but "soft" opinions, characterizations, or predictions, which defendants may challenge as too indefinite to matter to investors. A certain amount of sales "puffery" may be immaterial, *see ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 206 (2d Cir. 2009), but merely because a statement is imprecise does not render it "puffery." *See Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1092-95 (1991) ("conclusory" terms like "high" or "fair" may be material); *Novak v. Kasaks*, 216 F.3d 300, 315 (2d Cir. 2000) (statements such as "in good shape" or "under control" may be actionable under §10(b)); *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 281-282 (3d Cir. 1992) ("adequate," "conservative," "cautious"). Distinguishing "puffing" statements from material (though imprecise) ones requires an evaluation of the context in which the statement was made and the aspects of the business at issue. *See Casella v. Webb*, 883 F.2d 805, 808 (9th Cir. 1989) ("What might be innocuous 'puffery' or mere statement of opinion standing alone may be actionable as an integral part of a representation

of material fact ...."); *City of Monroe Empls. Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 672 (6th Cir. 2005) ("a company's statements that it is 'premier,' 'dominant,' or 'leading' must not be assessed in a vacuum..." (quotations omitted)).

Materiality may also depend on whether the statement carried with it qualifiers that rendered any undisclosed facts immaterial to the reasonable investor.[2] For example, a corporation may temper optimistic statements with specific warnings or other hedges that neutralize any misleading impression that the statement, standing alone, may have given. *See, e.g., In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 377 (3d Cir. 1993). But such warnings must be closely examined to determine whether they match in intensity and specificity any undisclosed risks. *See, e.g., Lormand v. US Unwired, Inc.*, 565 F.3d 228, 247-48 (5th Cir. 2009). Again, this is a fact-specific inquiry that often depends on the conditions that existed at the time of the statement, and the degree to which any warnings encompassed those conditions.

When it comes to contingent events, materiality depends on the *magnitude* of the event in light of the company's overall activity, and its *likelihood* of occurring. *See Basic*, 485 U.S. at 238-39. In *Basic*, this issue arose in the context of a potential merger, *see id.*; *see also Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 181-82, 185-86 (2d Cir. 2001); *McCormick v. Fund Am. Cos.*,

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2. This is known as the "bespeaks caution" doctrine, which was codified in the PSLRA as the "safe harbor" for forward-looking statements. *See* 15 U.S.C. §78u-5; *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194 n.23 (1st Cir. 1996).

26 F.3d 869, 876-77 (9th Cir. 1994), but it can arise in other contingent contexts, such as pharmaceutical trials, *e.g.*, *In re Transkaryotic Therapies*, 319 F. Supp. 2d 152, 160-61 (D. Mass. 2004), and new business plans, *e.g.*, *Lormand*, 565 F.3d at 248-49.

Finally, materiality may be assessed in light of other information known to the market, as Amgen argues here. But this also raises complicated questions, because whether general market information completely neutralized a false statement depends on a case-by-case assessment of the facts, such as the source and credibility of the offsetting information and how directly it challenged defendants' false statements. *See, e.g.*, *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 167-68 (2d Cir. 2000); *Provenz v. Miller*, 102 F.3d 1478, 1493 (9th Cir. 1996); *In re Massey Energy Co. Sec. Litig.*, 2012 WL 3156765, at *11 (S.D. W. Va. Mar. 27, 2012).

As is evident from such precedents, a proper examination of materiality often cannot be accomplished without considerable discovery. It may, for example, be necessary to assess precisely what the "true" conditions were when a statement was made to determine whether a defendant's "cautionary language" adequately disclosed the relevant risks, *see Asher v. Baxter Int'l Inc.*, 377 F.3d 727, 734-35 (7th Cir. 2004) (interpreting PSLRA's safe harbor), or expert evidence may be required to explain the significance of a fact within the context of all fraud-related facts.

Discovery will often be particularly important when the fraud allegedly occurred over a prolonged period. Most securities class actions do not involve a single false

statement, but instead involve multiple misstatements and material omissions over a class period that may span several years. *See, e.g.*, *In re Lehman Bros. Sec. & ERISA Litig.*, 799 F. Supp. 2d 258, 269-72, 275-92 (S.D.N.Y. 2011); *In re Wash. Mut., Inc. Sec.*, 694 F. Supp. 2d 1192, 1205-20 (W.D. Wash. 2009). The undisclosed truth may change over time – for example, where problems grow progressively worse, or the number of fraudulent transactions grows larger. *See, e.g.*, *In re Vivendi Universal, S.A., Sec. Litig.*, 634 F. Supp. 2d 352, 354-56 (S.D.N.Y. 2009); *In re NTL Inc. Sec. Litig.*, 347 F. Supp. 2d 15, 25-26 (S.D.N.Y. 2004). Under such circumstances, the cumulative effects of the fraud may be revealed at the end of the class period, but the size of the misstatements at earlier points may not be evident (particularly when the fraud was just beginning). As a result, prior to discovery, it may be impossible for plaintiffs to quantify the impact of the fraud at a given time. Thus, the only way for courts to evaluate the materiality of the omitted information for the *whole* class period is to first have merits discovery.[3] And because defendants can be expected to dispute whether there was any fraud to begin with, questions about the *size* of the fraud (and thus its *materiality*) are necessarily entangled with issues of *falsity*.

Discovery will also likely be necessary to determine how the defendants themselves viewed the relevant facts.

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3. A similar dilemma arises when a company's warnings and qualifiers remain the same over time, but the undisclosed facts grow increasingly dire. *See, e.g.*, *Baxter*, 377 F.3d at 734; *Slayton v. Am. Express Co.*, 604 F.3d 758, 772-73 (2d Cir. 2010). Without full discovery, it may be impossible to pinpoint when the undisclosed facts reached the point that the company's warnings were no longer sufficient to "neutralize" the falsity of its statements.

"A major factor in determining whether information was material is the importance attached to it by those who knew about it." *Media Gen., Inc. v. Tomlin*, 387 F.3d 865, 870 (D.C. Cir. 2004) (quotations and alterations omitted)). Or, as former SEC Chair Arthur Levitt put it, "Some companies ... intentionally record errors within a defined percentage ceiling. They then try to excuse that fib by arguing that the effect on the bottom line is too small to matter. If that's the case, why do they work so hard to create these errors?" Arthur Levitt, *The "Numbers Game," Remarks at NYU Center for Law and Business* (Sept. 28, 1998), *available at* http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt.[4] Indeed, in *Basic* itself, this Court held that the materiality of a potential merger turned on "indicia of interest in the transaction at the highest corporate levels," as evidenced by "board resolutions, instructions to investment bankers, and actual negotiations between principals or their intermediaries may serve as indicia of interest," 485 U.S. at 239 – information that is only be available after discovery.

II. IN THE SIMPLEST CASES, MATERIALITY IS DECIDED ON THE PLEADINGS

Despite the complexity of the materiality inquiry, in the simplest cases, defendants often successfully challenge materiality on the pleadings. Thus, by the time a case reaches class certification, any easy materiality issues will likely have already been addressed, leaving only

4. This is not to say that the mere fact that an error is intentional renders it material, or that corporate insiders are a proxy for the reasonable shareholder. Nonetheless, the company's internal attitude toward the information may provide powerful *evidence* of materiality.

the more difficult ones – which are most in need of full discovery – remaining.

The PSLRA imposes heightened pleading standards and stays discovery during the pendency of a motion to dismiss. *See* 15 U.S.C. §78u-4(b)(1-3). Virtually all Section 10(b) complaints are therefore subject to at least one motion to dismiss under Rule 12(b)(6), at which time defendants often argue that at least some of the alleged misstatements were immaterial, as Amgen did here. *See In re Amgen Inc. Sec. Litig.*, 544 F. Supp. 2d 1009, 1025-27 (C.D. Cal. 2008). Contrary to the argument of Amgen's amici that such motions apply "liberal" pleading standards, *see* Former SEC Commissioners Brief at 15-16, in fact courts conduct a thorough materiality analysis on the pleadings and frequently dismiss claims on materiality grounds. *See* David A. Hoffman, *The "Duty" To Be a Rational Shareholder*, 90 Minn. L. Rev. 537, 542 (2006) (of all Rule 12(b)(6) opinions addressing materiality, half dismissed claims for lack of materiality); Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does--Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 Emory L.J. 83, 116 n.94 (2002) (in one survey, 70% of securities dismissals held that at least one alleged misstatement was immaterial).

Nor are courts required to confine their analysis to the complaint when evaluating materiality on the pleadings. On a motion to dismiss, courts may also consider "documents incorporated into the complaint by reference, and matters of which a court may take judicial notice." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007). Typically, courts review any SEC filings in which the statement appeared, as well as any other SEC filings in

which related disclosures were made. *See In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1331 (3d Cir. 2002). Courts also consider stock prices, news articles, analyst reports, accounting standards, government reports and findings, filings in other cases and other documents deemed to be judicially noticeable.[5]

Thus, it is commonplace for defendants to file literally hundreds of pages of exhibits in connection with motions to dismiss.[6] Though these documents are not submitted for the truth of the matters asserted, *see, e.g.*,

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5. *See Wolfe v. Aspenbio Pharma*, 2012 WL 4040344, at *2 (D. Colo. Sept. 13, 2012) (taking judicial notice of "documents publicly filed with the SEC and/or the courts, and publications of federal agencies"); *Carlucci v. Han*, 2012 WL 3242618, at *15 (E.D. Va. Aug. 7, 2012) (judicially noticing a patent application); *Phillips v. Triad Guar., Inc.*, 2012 WL 259951, at *4 (M.D.N.C. Jan. 27, 2012) (judicial notice of marketwide disruptions); *In re XenoPort, Inc. Sec. Litig.*, 2011 WL 6153134, at *3 (N.D. Cal. Dec. 12, 2011) (judicial notice of "documents quoted or referenced in the [complaint], XenoPort's stock prices, FDA guidance, and SEC filings"); *In re MBIA, Inc. Sec. Litig.*, 700 F. Supp. 2d 566, 575 n.7 (S.D.N.Y. 2010) (reviewing analyst reports to "determin[e] what the market knew"); *Wilamowsky v. Take-Two Interactive Software, Inc.*, 818 F. Supp. 2d 744, 756 n.8 (S.D.N.Y. 2011) (press coverage and regulatory filings); *In re American Apparel, Inc. S'holder Litig.*, 2012 WL 1131684, at *14 (C.D. Cal. Jan. 13, 2012) (SEC investor bulletin); *In re Seracare Life Sciences, Inc.*, 2007 WL 935583, *4 (S.D. Cal. Mar. 19, 2007) (accounting standards and bankruptcy court brief); *In re White Elec. Designs Corp. Sec. Litig.*, 416 F. Supp. 2d 754, 760 (D. Ariz. 2006) (SEC filings, press releases, and accounting rules).

6. Here, the district court took judicial notice of several exhibits submitted by Amgen, including printouts of FDA websites and an analyst report. *See Amgen*, 544 F. Supp. 2d at 1023-24.

In re Merrill Lynch Auction Rate Sec. Litig., 2012 WL 1994707, at *2 (S.D.N.Y. June 4, 2012); *Salomon Analyst Winstar Litig.*, 2006 WL 510526, at *4 n.6 (S.D.N.Y. Feb. 28, 2006), courts may use them to evaluate the context in which defendants' statements were made, other information then available to the market, and the relationship of the false statement to defendants' business. Defendants therefore have ample opportunity at the outset to weed out facially immaterial statements. *See, e.g.*, *Garber v. Legg Mason Inc.*, 347 Fed. Appx. 665, 669 (2d Cir. 2009) (deciding on the pleadings that press coverage rendered omissions immaterial); *In re Bank of Am. Corp. Securities, Derivative, & ERISA Litig.*, 2012 WL 1353523, at *7-8 (S.D.N.Y. Apr. 12, 2012) (truth was disclosed in news articles).[7] Indeed, scholars have criticized judges as too quick to dismiss claims on materiality grounds, arguing that in so doing "federal judges are claiming - at least implicitly - a level of expertise about the workings of markets and organizations that, in some areas, not even

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7. *See also In re Yukos Oil Co. Sec. Litig*, 2006 WL 3026024, at *21 (S.D.N.Y. Oct. 25, 2006) (omission immaterial "in light of the wealth of publicly available information"); *In re UBS Auction Rate Sec. Litig.*, 2010 WL 2541166, at *23 (S.D.N.Y. June 10, 2010) (omission immaterial/reliance unreasonable in light of "the company-specific disclosures in the prospectuses combined with the publicly available information..."); *White v. H&R Block, Inc.*, 2004 WL 1698628, at *12 (S.D.N.Y. July 27, 2004) (false statements rendered immaterial by court filings and press coverage); *Smith v. Circuit City Stores, Inc.*, 286 F. Supp. 2d 707, 721 (E.D. Va. 2003) (omissions rendered immaterial by disclosures in analyst reports); *In re Merrill Lynch Auction Rate Sec. Litig.*, 704 F. Supp. 2d 378, 396 (S.D.N.Y. 2010) (truth adequately disclosed by, *inter alia*, press coverage of SEC investigation and order); *Iron Workers Local 16 Pension Fund v. Hilb Rogal & Hobbs Co.*, 432 F. Supp. 2d 571, 581-82 (E.D. Va. 2006) (truth adequately disclosed in various analyst reports).

the most sophisticated researchers in financial economics and organizational theory have reached." Bainbridge & Gulati, *supra*, at 84; *see id.* at 120-21, 134 (criticizing courts that invoke market theories of materiality without consulting financial literature).[8]

This means that by the class certification stage any "low hanging fruit" has been eliminated, leaving only the more difficult materiality questions – i.e., precisely the ones that most require full discovery and expert analysis. For these questions, resolution at class certification (as opposed to summary judgment upon a full factual record) is neither practical nor desirable.

III. MATERIALITY DETERMINATIONS AT CLASS CERTIFICATION ARE IMPRACTICAL AND WOULD WASTE JUDICIAL RESOURCES

A. The Initial Stages of Section 10(b) Litigation Are Already Unusually Prolonged

After a Section 10(b) class action is filed, the court must first select a "lead plaintiff." The PLSRA contains special procedures for the selection of lead plaintiffs, due to Congress's belief that institutional investors, in particular, are well-suited to that role. *See In re Cendant Corp. Litig.*, 264 F.3d 201, 261-62 (3d Cir. 2001). The first plaintiff to file a complaint must issue a notice within 20 days. 15 U.S.C. § 78u-4(a)(3)(A)(i). All affected investors then have 60 days to file a lead plaintiff application. 15 U.S.C. § 78u-4(a)(3)(A)(i)(II). If there is more than one

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8. *See also* Stefan J. Padfield, *Is Puffery Material to Investors? Maybe We Should Ask Them*, 10 U. Pa. J. Bus. & Emp. L. 339 (2008).

applicant, the PSLRA sets forth procedures for evaluating competing applications. *See generally In re Cavanaugh*, 306 F.3d 726, 729-31 (9th Cir. 2002). There may be several rounds of briefing before a lead plaintiff is selected.[9]

Next, courts typically give the lead plaintiff 30-60 days to file an amended complaint,[10] after which time defendants file their motions to dismiss. *See, e.g., Eastwood Enters., LLC v. Farha*, 2008 WL 687351, at *4 (M.D. Fla. Mar. 11, 2008); *In re XM Satellite Radio Holdings Sec. Litig.*, 237 F.R.D. 13, 21 (D.D.C. 2006). Full briefing can easily take 5-6 months, with oral argument to follow. It routinely takes over a year from the date that the case was first filed until motions to dismiss are decided – with all discovery stayed by the PSLRA in the interim. Often, the case is dismissed on the pleadings – indeed, 46% of resolved cases in 2009 were dismissed prior to summary judgment.[11] If plaintiffs are permitted to replead, further dismissal motions will take additional months (and often much longer) to resolve. *See, e.g., Curry v. Hansen Med., Inc.*, 2012 WL 3242447 (N.D. Cal. Aug. 10, 2012) (sustaining, in part, second amended complaint after prior dismissal); *In re SunPower Sec. Litig.*, 2011 WL 7404238 (N.D. Cal. Dec. 19, 2011) (same). "[T]he net

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9. The PSLRA requires lead plaintiffs to be appointed within 90 days of issuance of the notice, but permits courts more time when multiple complaints are filed that require consolidation. *See* 15 U.S.C. § 78u-4(a)(3)(B).

10. Because the lead plaintiff need not have filed its own complaint, *see* 15 U.S.C. § 78u-4(a)(3)(B)(i), it may have had no role in drafting the initially-filed complaints.

11. *See* Stanford Law School and Cornerstone Research, *Securities Class Action Filings: 2011 Year in Review* 31 Appendix 2 (2012) (hereinafter "Cornerstone Report").

result can be that many months or even years pass before discovery begins in earnest." Gideon Mark, *Confidential Witnesses in Securities Litigation*, 36 Iowa J. Corp. L. 551, 553 (2011).

Assuming the case reaches the class certification stage, further complex proceedings await. Most obviously, plaintiffs must establish that the relevant security traded efficiently, which involves analysis of the multiple factors identified in *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989) and *Krogman v. Sterritt*, 202 F.R.D. 467 (N.D. Tex. 2001). These include: (1) the causal relationship between unexpected company-specific disclosures and stock price reaction, as evidenced by an "event study"; (2) average weekly trading volume; (3) the number of "market makers" and arbitrageurs; (4) eligibility to file a Form S-3 registration statement; (5) the number of analysts following the issuer; (6) market capitalization; (7) "bid-ask spread"; and (8) the percentage of shares not owned by company insiders. Market efficiency is often hotly contested, resulting in a "battle of experts." *See, e.g., In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1 (1st Cir. 2005). And in addition to establishing market efficiency, plaintiffs must satisfy Rule 23's other requirements, such as "adequacy" and "typicality" – criteria that defendants routinely challenge by delving into the proposed representatives' knowledge of the litigation, background and myriad other subjects. *See, e.g., In re Wash. Mut., Inc.*, 2010 WL 4272567 (W.D. Wash. Oct. 12, 2010).[12] As a result, even in cases that meet the PSLRA's heightened

12. There may also be significant discovery disputes regarding the typicality and adequacy of the proposed representatives. *See, e.g., In re Qwest Commc'ns Int'l, Inc., Sec. Litig.*, 2005 U.S Dist. LEXIS 11618, at *15 (D. Colo. June 7, 2005); *In re Priceline.com Inc. Sec. Litig.*, 2005 WL 1366450, at *3 (D. Conn. June 7, 2005).

pleading standards, class certification decisions will often not issue until 3 or 4 years after the case was first filed.[13]

However, if materiality were added into the class certification equation, the need to conduct extensive additional fact and expert discovery in all but the simplest fraud cases would necessitate further delays. Such delays would create additional *inefficiency*, making a mockery of Rule 23's command that classes be certified "[a]t an early practicable time," Fed. R. Civ. P. 23(c)(1)(A), not to mention Rule 1's command that the rules "be construed ... to secure the just, speedy, and inexpensive determination of every action...." Fed. R. Civ. P. 1.

B. Materiality is Difficult to Evaluate at Class Certification

Most securities cases involve *multiple* false statements over the course of a potentially multi-year class period, often on different (though usually related) subjects. There may also be multiple *disclosures* over the course of a class period – each of which only reveals a portion of the truth concealed by the defendants. *See, e.g.*, *Lormand*, 565 F.3d at 261; *Steiner v. MedQuist Inc.*, 2006 WL 2827740, at *12 (D.N.J. Sept. 29, 2006); *Norfolk County Ret. Sys. v. Ustian*, 2009 WL 2386156, at *6 (N.D. Ill. July 28, 2009); *In re Bradley Pharms., Inc. Secs. Litig.*, 421 F. Supp. 2d 822, 828-29 (D.N.J. 2006). Those partial disclosures may be accompanied by additional false statements as

13. A Westlaw search of district court rulings on motions for class certification in §10(b) actions, issued within the last three years, revealed that those rulings issued, on average, 3.8 years after the case was first filed.

the company seeks to conceal the full extent of its fraud. *Freudenberg v. E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 202-03 (S.D.N.Y. 2010). This makes a statement-by-statement materiality analysis an exceptionally complex undertaking, particularly where – as in most cases – defendants have already eliminated any clearly immaterial statements at the pleading stage.

For example, *Amici* Chamber of Commerce et al. cite *In re American International Group Sec. Litig.*, 265 F.R.D. 157 (S.D.N.Y. 2010) ("*AIG*"), as an example of a case where the court effectively examined materiality at the class certification stage. Chamber Br. 23. As detailed at Part III.D below, *AIG*'s analysis is deeply flawed, but for present purposes one need only consider the complexity of its fact pattern. There, the plaintiffs alleged that AIG, over a six-year class period: (1) concealed that it bribed insurance brokers to steer business its way, (2) concealed its involvement in a bid-rigging scheme, (3) engaged in several different types of accounting fraud, including improper off-balance sheet transactions, reporting of false revenues on intra-company transactions, and understating its reserves, and (4) concealed the extent of certain investigations by the SEC, the New York Attorney General, and the Department of Justice. 265 F.R.D. at 162-63. The truth was not disclosed in a single neat announcement, but in a stream of announcements over prolonged period. *See id.* at 162-63. It is facially obvious that with such a fact pattern any attempt to parse materiality statement by statement at *class certification* (and *prior* to the completion of discovery) would ensnare the court in a tangle of highly complex issues – which is exactly what occurred. *See* Part III.D, *infra* (further discussing *AIG*).

Fact patterns like *AIG*'s are not uncommon. *See, e.g.*, *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 551, 556-57 (S.D.N.Y. 2011) (57 false statements and 9 disclosure dates proved at trial, including dates disclosing credit ratings downgrades and sudden asset sales that revealed liquidity problems)[14]; *Lehman Bros.*, 799 F. Supp. 2d at 269-72, 275-92, 305-07 (multiple false statements alleged over 15 months; alleged partial disclosures over four months); *In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1201 (C.D. Cal. 2008) (multiple misstatements over a 4-year class period; "Countrywide's corrective disclosures were made over an extended period of time and often in combination with alleged further misrepresentations that dampened the disclosures' price effects.").

In sum, Amgen's proposal to have a court evaluate the materiality of each individual statement at class certification would introduce a nightmare of subsidiary issues, especially in more complex cases, resulting in either idiosyncratic, standardless and unreliable "early" decisions (as exemplified by the cases cited by Amgen's amici that are further discussed below), or lengthy delays for the development of an appropriately full record.

C. "Price Impact" Evidence is Not a Workable Proxy for Materiality

Several *amici* suggest that instead of assessing materiality per se, courts should assess whether a

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14. *See also Vivendi*, 634 F. Supp. 2d at 356-59 (summary judgment opinion detailing alleged partial disclosures, which overlapped with additional false statements).

particular false statement "moved the market" (i.e., had a measurable effect on stock prices). *See* Chamber Br. at 19; Petitioners' Law Professors Br. at 26-34. But this suggestion is even less practical than a requirement that courts decide materiality at class certification under *Basic*'s "total mix" standard.

First, most cases will not involve a "front end" uptick in prices when the false statement is made. This is because most frauds do not involve the concoction of good news, but the concealment of bad news – such as the "last period problem." *See, e.g.*, Sean J. Griffith, *Towards an Ethical Duty to Market Investors*, 35 Conn. L. Rev. 1223, 1241-42 (2003). Typically, defendants determine that corporate results will not meet market expectations, and commit fraud to hide that fact. As a result, defendants' false statements – rather than introducing new positive information to the market – falsely confirm pre-existing information or expectations. Such "confirmatory" statements do not move market prices *upward*, but instead hold them steady. *See, e.g.*, *Alaska Elec. Pension Fund v. Pharmacia Corp.*, 554 F.3d 342, 352 (3d Cir. 2009); *FindWhat Investor Group v. FindWhat.com*, 658 F.3d 1282, 1314-15 (11th Cir. 2011); *see also* Sanjai Bhagat & Roberta Romano, *Event Studies and the Law, Part I*, 4 Am. L. & Econ. Rev. 141, 143 (2002); Frank Torchio, *Proper Event Study Analysis in Securities Litigation*, 35 J. Corp. Law 159, 164 (Fall 2009); Donald C. Langevoort, *Compared to What? Econometric Evidence and the Counterfactual Difficulty*, 35 J. Corp. L. 183, 185 (2009).[15] In other cases, defendants may gradually reveal

15. *Cf. Vivendi*, 765 F. Supp. 2d at 562-63 ("To hold, as Vivendi argues, that inflation must rise each time a misstatement

some problems but fraudulently downplay their severity, thereby causing prices to fall more slowly than they would have absent the fraud. *See Schleicher v. Wendt*, 618 F.3d 679, 683 (7th Cir. 2010). Notably, in neither scenario do the defendants' statements have no impact; rather, their impact is to *maintain* prices. Had defendants told the truth – or even had they remained silent when new statements were expected – prices would have fallen. *See* Torchio, *supra* at 165; Langevoort, *supra* at 185.[16]

Thus, if plaintiffs are required to prove that false information "moved the market," they will typically try to demonstrate "at the back end" that the market price dropped in response to a disclosure of the true state of affairs. This is, of course, an inquiry that is indistinguishable from "loss causation," and neither Amgen nor its amici argue otherwise. But as this Court has recently recognized, there are many reasons why the plaintiff's failure to prove that there was a stock price drop in reaction to a truthful disclosure does not indicate that the price was never inflated in the first place. It may be that any price drops were due to intervening events rather than the fraud. *See Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011). Or, defendants may disclose confounding

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is reiterated ... would produce a perverse result: it would make it harder for plaintiffs to prove loss causation when a company makes numerous similar misstatements over a long time period than when a company makes a single, isolated fraudulent statement, even though the former situation involves a more pervasive and widespread fraud." (citing cases)).

16. Amgen's *amici* concede this. *See* Petitioners' Law Professors Br. at 28 n.11.

information that makes it difficult to isolate the effect of the truthful revelation – a danger that scholars have warned against, fearful that bright-line price drop rules may hand defendants a roadmap for insulating themselves from liability.[17] Or, the truth may have become stale, so that it no longer influences prices as strongly as newer market and company-specific information (*see In re Credit Suisse First Boston Corp. (Lantronix, Inc.) Analyst Sec. Litig.*, 250 F.R.D. 137, 145 (S.D.N.Y. 2008)), or the truth may have leaked to the market, resulting in a gradual price decline that is difficult to measure (*see Schleicher*, 619 F.3d at 686-87). As Professor Langevoort observes, "the problem of information leakage, or professionals figuring out the problem before being told officially, or corrective disclosure bundled with positive news, all very plausible even in markets characterized by a high degree of efficiency. Event studies and similar analyses do not do well in assessing these other possibilities...." *Basic at Twenty*, *supra*, at 190.

Tellingly, this Court has already recognized that in such circumstances plaintiffs are still entitled to class certification, even though they may not be able to prove *loss causation* on the merits. *See Halliburton*, 131 S. Ct. at 2186. At minimum, none of the foregoing illustrative scenarios has anything to do with whether the initial false statement was material – which is precisely why a price-impact proxy serves as a wholly inadequate substitute for the Court's highly contextual "reasonable investor"

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17. *See* Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 Iowa L. Rev. 811, 852 (2009); Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 187 (hereinafter "*Basic at Twenty*").

test of materiality. Indeed, it is precisely because of such concerns that *Basic* held that the question of whether inflation dissipated over the class period is best left for trial. *See Basic*, 485 U.S. at 249 n.29; *cf. Greenhouse*, 392 F.3d at 661 ("We note only the commonsense proposition that judges are not stockbrokers, and that, even with the corrective lenses of hindsight, they must be chary of theories that purport to discern precisely what caused stock prices to rise or fall.").

Moreover, using a stock price drop upon revelation of the truth as a proxy for initial price impact is highly problematic when the materiality disputes concern the size of the alleged fraud. For example, defendants may admit that they misstated corporate revenues – but only by a small amount. If the market fails to react, this hardly suggests that defendants' earlier statements about their revenues were immaterial, or that their revenue reports did not influence the stock price, which is the only potentially relevant question at class certification (as Amgen concedes, Pet. Br. 17). Instead, the only possible materiality inference (if any) is that the size of the discrepancy that defendants confessed to was not material. But *that* question has nothing to do with whether the stock price was impacted by the initial statements themselves, the fraud-on-the-market presumption, or class certification. Thus, even if there was a materiality dispute, it would present a quintessential merits question that is entirely divorced from the requirements of Rule 23.

Finally, in many cases, there are disputes about whether the particular disclosure that caused a price drop was, or was not, related to the fraud. *See, e.g., Vivendi*, 765 F. Supp. 2d at 556-60. As explained in the brief filed by

Amici Financial Economists, these disputes – like other materiality questions – also will often require merits discovery to resolve.

D. Cases Cited by Petitioners' *Amici* Illustrate the Perils Of Having Courts Evaluate Materiality at Class Certification

Amgen's *amici* cite certain decisions within the Second Circuit as examples of cases where courts were able to assess materiality at class certification. See Chamber Br. at 20-24. In fact, a closer look demonstrates that those courts have had serious trouble with the inquiry, and even adopted approaches that conflict with the fraud-on-the-market theory. Therefore, far from establishing the appropriateness of requiring materiality to be evaluated at class certification, these decisions illustrate why it should not be. It should also be noted that, in *every* case cited, the only price impact evidence came from drops upon disclosure of the fraud, and not upticks upon the initial false statements.

First, two of the cited cases plainly erred by rejecting the proposition that material information that confirms existing expectations will not cause stock prices to move. This fundamental misunderstanding caused both courts to incorrectly interpret the lack of price movement at the time of the initial misstatements as affirmative evidence that the statements had no effect. *See Credit Suisse*, 250 F.R.D. at 144-45; *In re Moody's Corp. Sec. Litig.*, 274 F.R.D. 480, 492-93 (S.D.N.Y. 2011). However, as discussed above, it is a fundamental economic principle that only *unexpected* information will result in a price change.

The implications of such patently flawed reasoning are illustrated by examining the facts of *Moody's*. There, many of the allegedly false statements appeared in annual reports on Form 10-K (which all public companies must file with the SEC). *See In re Moody's Corp. Sec. Litig.*, 599 F. Supp. 2d 493, 501 (S.D.N.Y. 2009). Forms 10-K are the single most comprehensive source of information about an issuer, as they contain (inter alia) complete financial statements as well as management's detailed discussion and analysis of the company's operations. *See* SEC Regulation S-K, 17 C.F.R. § 229.101 et seq. Yet, according to *Moody's*, because there was no measurable *uptick* when the 10-Ks issued, the false statements contained therein – and, by the same logic, *every other piece of information in the 10-K* – had no impact on prices. This is an extraordinary conclusion: it would mean that had Moody's subsequently announced that every word in the 10-K was false, investors would have had no claim.

Next, *Moody's* considered whether there had been price *drops* upon disclosures of the truth, agreeing that such drops occurred on two separate dates. 274 F.R.D. at 492-93. Nonetheless, the court refused to accept the drops as evidence that the misstatements affected prices because the plaintiffs had chosen an earlier class period end date. *Id.* at 493. But this is a non sequitur: if a price drop upon disclosure of the truth indicates that the price was previously inflated, it hardly matters whether the plaintiffs artificially cut their class period short; the drop alone would still mean that investors within the class period bought at inflated prices.

Credit Suisse offers an equally flawed analysis. There, the court rejected price drop evidence because the court believed there had been intervening factors, including

economic developments prior to the price drop, that erased the effects of the initial false statements. 250 F.R.D. at 146-49. But as this Court recognized, intervening factors should not be used a basis for denying certification. *See Halliburton*, 131 S. Ct at 2186; *see also In re Alstom SA Sec. Litig.*, 253 F.R.D. 266, 281 (S.D.N.Y. 2008) (criticizing *Credit Suisse* for improperly requiring plaintiffs to demonstrate loss causation at class certification). Indeed, *Credit Suisse* itself acknowledged that "Plaintiff has proffered evidence which, if credited, would constitute a modest showing of market impact" – but still decertified the class. *Id.* at 142 n.11.

AIG presents another example of illogical stock price analysis. As discussed above, the *AIG* plaintiffs alleged a series of false statements concerning AIG's accounting and business methods. Defendants attempted to rebut the fraud-on-the-market presumption by arguing that there had been no market movements in response to any alleged partial disclosures of the truth, and thus no artificial inflation initially. *See* 265 F.R.D. at 181 & n.20. In response, plaintiffs introduced expert evidence showing that there *had* been a stock price drop on four dates when new facts emerged concerning the extent of the fraud: March 17, 30 and 31, and April 1. *Id.* at 184-88. However, on March 30 and March 31, the price drops were not established at the 95% confidence level typically required for statistical significance. *Id.* at 187. As a result, the court held that the fraud-on-the-market presumption was rebutted for March 30 and March 31, but not for March 17 and April 1, and defined the class accordingly. *Id.* at 188.

This was facially nonsensical. The false statements had issued much earlier – so by March 30 either the stock price was inflated, or it was not. Apparently, in the court's

view, the stock was inflated until March 17, then deflated to its unmanipulated level by March 30, and then – without any intervening false statements[18] – suddenly re-inflated after the disclosures on March 31, only to drop one day later on April 1. Obviously, such reasoning has nothing to do with *Basic*, fraud-on-the-market, or any other recognizable economic theory.

More importantly, *AIG*'s entire evaluation of stock price drops was divorced from the allegations in the case. The plaintiffs claimed that AIG had extensively manipulated its financial performance for *six years*. Whether the market reacted – or not – to one of a long series of disclosures calling its financial statements into question hardly suggests that the market ignored AIG's financial statements throughout the class period. That the court engaged in this inquiry at all demonstrates how disconnected the "price impact" approach was from the actual issue that was purportedly under consideration – namely, whether AIG's false statements inflated the price of its stock.[19]

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18. The plaintiffs did not allege that AIG made additional false statements between March 17 and March 31. *See* Third Amended Complaint, *In re AIG Sec. Litig.*, No. 04-8141 (S.D.N.Y. Dec. 15, 2006), ECF No. 308.

19. *Berks County Emples. Ret. Fund v. First Am. Corp.*, 734 F. Supp. 2d 533 (S.D.N.Y. 2010) similarly does not support an argument that materiality is a simple matter at class certification. In that case, the plaintiffs did not submit any evidence regarding how a reasonable shareholder would have interpreted the statements, or evidence of how the fraud impacted the total mix of information – leaving the district court with an unusually bare record. *See id.* at 538-39. Indeed, the plaintiff's only expert conceded that he had not been retained to evaluate materiality. *See id.* at 539 n.35.

In two further cases cited by amici (Chamber Br. 22-23), the stock price drop upon disclosures of the truth was indisputable, and therefore the decisions focused solely on *Basic*'s "total mix" standard. But even these cases did not suggest that materiality is a simple matter at class certification. In the first, *In re Monster Worldwide Securities Litigation*, 251 F.R.D. 132 (S.D.N.Y. 2008), the plaintiff had previously moved for summary judgment on materiality – thus, there was an unusually clear record, including defendants' own implicit admissions of materiality. *Id.* at 137-38. In the second, *In re Sadia, S.A. Securities Litigation*, 269 F.R.D. 298 (S.D.N.Y. 2010), to assess materiality the court relied on a stock price drop when the truth was disclosed, on class representative and expert testimony, and on the court's own "common sense" to find that the misstatements were material. *Id.* at 315. Although Amicus NASCAT has no quarrel with the *outcome* in *Sadia*, its reasoning was ultimately standardless, as the court's "common sense" in one case is no guide to what a court's "common sense" will be in another – and is an inquiry facially more suited for a jury. This is particularly true given that, as discussed above, cases that present simple materiality issues will be disposed of on the pleadings.

In sum, Petitioner's *amici*'s cases confirm that requiring an evaluation of materiality at class certification – let alone one premised on "price impact" evidence – is impractical and unworkable, as it would force courts to make premature determinations on matters that cannot be reliably assessed before the completion of merits discovery. Nor is their proposal necessary, as weak materiality cases are dismissed under Rule 12(b)(6). Indeed, in most cases, the rule proposed by Amgen and its amici flies in face of *Halliburton* by requiring courts to perform the same

kind of loss causation analysis (albeit under the rubric of "materiality") that *Halliburton* rejected as unnecessary at class certification.

IV. SECURITIES CLASS ACTIONS CONTRIBUTE TO STRONGER MARKETS AND GOOD CORPORATE GOVERNANCE

The practical problems inherent in requiring plaintiffs to prove materiality at class certification are not unknown to Amgen and their amici, which likely explains why they devoted so much of their briefing to the perceived evils of securities litigation and the supposed need to protect corporations from "blackmail settlements."

The most obvious response is that Congress disagrees. Faced with precisely these arguments in 1995, Congress passed the PSLRA, which instituted several measures to curb abusive lawsuits and reduce undue pressures to settle. In addition to imposing heightened pleading standards and staying discovery until the complaint has survived motions to dismiss, the PSLRA also limits defendants' joint and several liability, thus significantly reducing their exposure to damages. *See* 15 U.S.C. §78u-4(f)). It also requires plaintiffs to prove loss causation, so that defendants will not be liable for price declines unrelated to the fraud, and limits damages in cases where the market quickly rebounds after a negative disclosure. 15 U.S.C. §§78u-4(b)(4); 78u-4(e). It also provides special protections for "forward-looking statements." 15 U.S.C. §78u-5. And, to strengthen the role of institutional investors, it adds new procedures for selecting lead plaintiffs. 15 U.S.C. §78u-4(a)(3). These provisions have succeeded both in increasing the number of weak cases that are

dismissed, as discussed below, and in increasing recoveries for investors in meritorious cases that survive the PSLRA's new hurdles.[20]

What Congress did *not* do, however, is change the standards for class certification. To the contrary, "[Congress] incorporated Rule 23 explicitly in one portion of the statute, and enacted language that is identical to Rule 23's typicality and adequacy requirements in a nearby provision. Given the many other changes Congress did make, we must infer that its decision to leave the standards of Rule 23 intact was deliberate." *Cavanaugh*, 306 F.3d at 739. Thus, if Amgen and its amici believe that, despite the PSLRA, investor-plaintiffs still hold too much power over corporate defendants, their complaints are better directed to Congress.

More fundamentally, the notion of class certification being used to "blackmail" defendants into settling frivolous claims has been thoroughly debunked. For example, Amgen's *amici* cite Janet Cooper Alexander's *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497 (1991) as evidence of the prevalence of blackmail settlements. *See* Former SEC Commissioners Br. at 16. But this article – written before

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20. The rate of institutional participation as lead plaintiffs has been climbing since the PSLRA was passed, and institutional plaintiffs are associated with larger recoveries for class members and lower attorneys' fees. *See* NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2011 Year-End Review* 19 (2011); C.S. Agnes Cheng et al., *Institutional Monitoring Through Shareholder Litigation*, 95 J. Fin. Econ. 356, 358-60 (2010); Jill E. Fisch, *The Overstated Promise of Corporate Governance*, 77 U. Chi. L. Rev. 923, 938 (2010).

the PSLRA's enactment – has been seriously undermined by subsequent research. *See, e.g.*, Joel Seligman, *The Merits Do Matter: A Comment on Professor Grundfest's "Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority,"* 108 Harv. L. Rev. 438, 448-455 (1994); Geoffrey Miller, *Access to Justice: Investor Suits in the Era of the Roberts Court: A Modest Proposal for Securities Fraud Pleading after Tellabs*, 75 Law & Contemp. Probs. 93, 99 (2012).[21] Amici argue that a 1996 study concluded that blackmail settlements are a problem. *See* Former SEC Commissioners Br. at 16. In fact, that study found that "there were *no* objective indications that settlement was coerced by class certification," Thomas E. Willging, et al., *Empiral Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules* 90 (Federal Judicial Center 1996) (emphasis added), and that attempted strike suits were adequately addressed via dismissals on the pleadings or at summary judgment, *without* settlement. *Id.*

In any event, whatever concerns one might have had about frivolous securities litigation in the past, these have been addressed by the PSLRA. Since then, securities claims have been dismissed at much higher rates, and

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21. *See also* James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 Ariz. L. Rev. 497, 503-04 (1997); Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 Yale L.J. 2053, 2080-84 (1995); Leonard B. Simon & William S. Dato, *Legislating on a False Foundation: The Erroneous Academic Underpinnings of the Private Securities Litigation Reform Act of 1995*, 33 San Diego L. Rev. 959, 990-93 (1996).

those rates climb year after year. *See* Cornerstone Report 31 Appendix 2[22]; *see also* Stephen J. Choi at al., *The Screening Effect of the Private Securities Litigation Reform Act*, 6 J. Empirical Legal Stud. 35, 48 (2009) (comparing dismissal rates pre- and post-PSLRA); Christine Hurt, *The Undercivilization of Corporate Law*, 33 Iowa J. Corp. L. 361, 389 (2008) (same). As the Fifth Circuit put it, with former Justice O'Connor sitting by designation, "to be successful, a securities class-action plaintiff must thread the eye of a needle made smaller and smaller over the years by judicial decree and congressional action." *Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221, 235 (5th Cir. 2009) (per curiam).[23]

There is every reason to believe the PSLRA's heightened pleading standards will continue to be enforced, as the increasing dismissal rates identified in the Cornerstone Report confirm. Indeed, a study of how "motive" allegations are used to meet the PSLRA's heightened scienter pleading standard shows that courts have continually narrowed the types of "motive" evidence that they will accept. *See* Hillary A. Sale, *Judging Heuristics*, 35 U.C. Davis L. Rev. 903, 923-46 (2002).

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22. These figures include claims filed under Section 11 of the Securities Act of 1933, which does not have scienter, loss causation, or reliance requirements. The rate of dismissal for Section 10(b) claims is likely much higher.

23. *See also* Hurt, *supra*, at 402, 387 ("the pleading and evidentiary burdens on plaintiffs in [securities fraud] civil cases is quite high, and a large number of cases are dismissed prior to discovery at the pleading stage... To increase the level of specificity that plaintiffs must know and plead but to block the same plaintiffs from any information-producing discovery creates a catch-22 situation that few can surmount....").

At the same time, scholars have documented how securities class action litigation improves corporate governance. Class action lawsuits deter aggressive financial reporting both at the targeted firm and – more interestingly – even at peer firms in the same industry. *See* Jared N. Jennings, Simi Kedia, and Shivaram Rajgopal, *The Deterrent Effects of SEC Enforcement and Class Action Litigation* (December 2011), http://ssrn.com/abstract=1868578. One study found that "these lawsuits appear to change firm behavior towards better governance, greater focus, and lower overinvestment." Brian Carson McTier & John K. Wald, *The Causes and Consequences of Securities Class Action Litigation*, 17 J. Corp. Fin. 649, 663 (2011), while another concluded that "institutional investors' involvement in securities litigation enhances ... the quality of the defendant firms' corporate governance. In light of the ineffectiveness of traditional institutional monitoring channels (e.g., private communication and filing proposals, etc.) and the increasing number of securities litigations, institutional investors could use litigation as a mechanism to discipline management and to secure the long-term health of the firms." Cheng, *supra*, at 381; *see also* Geraldine Szott Moohr, *The Balance Among Corporate Criminal Liability, Private Civil Suits, and Regulatory Enforcement*, 46 Am. Crim. L. Rev. 1459, 1470 (2009) ("Studies show that private civil suits may also be more effective in regulating financial markets than public enforcement.....").

Private securities fraud class actions also serve as a necessary complement to public enforcement by the SEC. As Professor Samuel Issacharoff observes, the SEC relies on ex post enforcement actions – both private and public – to regulate the markets, rather than directly regulating business transactions themselves ex ante. Samuel

Issacharoff, *Regulating After the Fact*, 56 Depaul L. Rev. 375, 379 (2007). An ex post model is particularly suited to private enforcement, *see id.* at 381-82, and – compared to countries that use ex ante regulation – contributes to freer, better developed markets, *see id.* at 376-77, 385. Given that "'[t]he resources of the [SEC] are adequate to prosecute only the most flagrant abuses,' private litigation mechanisms ... may often be needed to prevent a noninsignificant amount of misconduct from escaping regulation." J. Maria Glover, *The Structural Role of Private Enforcement Mechanisms in Public Law*, 53 Wm. & Mary L. Rev. 1137, 1159-60 (2012) (quotations omitted). Securities class actions, subject to the limitations already placed by the PSLRA, thus continue to play a critical role in the enforcement of the securities laws.

CONCLUSION

For the foregoing reasons, this Court should not require courts to determine whether the alleged misstatements were material as part of the class certification inquiry in a fraud-on-the-market action. The decision of the Ninth Circuit should be affirmed.

Respectfully submitted,

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AMICUS CURIAE BRIEF

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v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF THE NEW YORK CITY PENSION FUNDS, *ET AL.* AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICI CURIAE*[1]

Amici curiae are institutional investors that regularly engage in transactions of publicly traded securities. The New York City Pension Funds consist of the actuarial pension systems of the New York City Employees' Retirement System, the New York City Policy Pension Fund, the New York City Fire Department Pension Fund, the New York City Board of Education Retirement System, and the Teachers' Retirement System of the City of New York. Collectively, the New York City Pension Funds have assets under management exceeding $123 billion and serve more than 700,000 current and retired employees.

Because *amici* have an obligation to protect the integrity of the investments they make on behalf of the thousands of individual clients they serve, the *amici* have a fundamental interest in the procedural requirements for bringing actions against publicly-traded companies and their officers to redress violations of the federal securities laws. Indeed, perhaps no *amici* have a greater stake in the procedural requirements for securities class actions lawsuits than institutional investors because the Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (1995), includes "several requisites ... to encourage the selection of institutional investors as lead plaintiffs," in securities class action

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amici* represents that they authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *amici* or their counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Letters from counsel for both petitioners and respondent granting blanket consent to the filing of *amicus* briefs are on file with the Clerk.

lawsuits. Mary K. Kane, et al., *Federal Practice & Procedure* §1806 (2012); *see also* Charles M. Silver & Sam Dinkin, *Incentivizing Institutional Investors to Serve as Lead Plaintiffs in Securities Fraud Class Actions*, 57 DEPAUL L. REV. 471 (2008).

The PSLRA in fact mandates that district courts appoint as lead plaintiff investors the "largest financial interest" in the relief sought by the class. *In re Cavanaugh*, 306 F.3d 702 (9th Cir. 2002); *In re Cendant Corp. Secs. Litig.*, 264 F.3d 201 (3rd Cir. 2001). This requirement was designed to encourage the selection of institutional investors as lead plaintiffs because such entities are "deemed to have a large enough financial interest in the litigation and sufficient professional expertise in directing litigation to ensure that class members' interests are competently and dutifully served." *Federal Practice & Procedure* §1806, at n.22. "Institutional investors, [Congress] believed, are less likely to bring abusive or meritless litigation." *Id.* at n.23. As part of the overall congressional design, therefore, *Amici* have a unique and compelling interest in the procedural requirements for securities class action cases.

Affirmance of the decision below thus would further a primary purpose of the PSLRA by assisting institutional investors, such as *Amici*, in fulfilling their congressionally assigned obligation to prosecute securities fraud actions.

SUMMARY OF ARGUMENT

The sole question for this Court is whether the courts below correctly applied the "predominate" standard of Federal Rule of Civil Procedure 23(b)(3). The answer is emphatically yes.

I.A.1. The text of Rule 23(b)(3) controls this case. Petitioners' brief does little more than regale this Court with a series of debatable, subjective public policy contentions. The Court's lodestar in Federal Rules cases, however, is the plain meaning of the text. *See Pavelic & LeFlore v. Marvel Entm't Group*, 493 U.S. 120, 123 (1989); *Bank of Nova Scotia v. United States*, 487 U.S. 250, 255 (1988).

To the extent Petitioners engage the text of Rule 23 at all, see *Pet. Br.* at 19–24, they abandon the Rule's plain language and add a requirement that is simply not there. Although district courts may take a "peek" at the merits in some instances at the class-certification stage, Rule 23 authorizes that quick look only for the narrow purpose of ensuring that common questions susceptible to *common answers* will predominate at trial. FED. R. CIV. P. 23, official cmts. (2003). Petitioners attempt to extrapolate this limited merits review into a requirement that the district court actually adjudicate the common answer to the merits question of "materiality" at the certification stage. The plain text of Rule 23(b)(3), however, speaks in terms of "find[ing]" "common questions" not determining common pro-plaintiff conclusions.

I.A.2. Nor does Petitioners' interpretation of Rule 23 square with *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011), because an essential determinant for class certification is "the capacity of a classwide proceeding to generate common answers." *Id.* at 2552 (internal quotations omitted). Petitioners would add

an additional requirement: that the district court actually adjudicate the common answers in favor of the putative class. *Wal-Mart* rejected that course, emphasizing that the court's duty at the certification stage is to find "a common contention .... [that is] of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." *Id.* at 2551.

I.B. Last term's decision in *Erica P. John Fund v Halliburton*, 131 S.Ct. 2179 (2011), sets the better course here. In *Halliburton*, a unanimous Court rejected the proposition that in order to certify a class in a fraud-on-the-market suit the district court must adjudicate the merits of "loss causation." *Id.* at 2184. Just as it did in *Halliburton*, the Court should reject Petitioners' invitation to add another certification requirement–proof of the element of materiality–to Rule 23(b)(3), because such a "requirement is not justified by *Basic* or its logic." *Halliburton*, 131 S. Ct. at 2185; *see also Schleicher v. Wendt*, 618 F.3d 679, 687 (7th Cir. 2010) ("whether a statement is materially false is a question common to all class members and therefore may be resolved on a class-wide basis after certification.").

II.A. Affirmance will not deprive Petitioners of an opportunity to air their policy arguments. When confronted with non-textual arguments for revising the Federal Rules, this Court consistently re-routes such arguments to the Civil Rules Advisory Committee and the rulemaking process. *See, e.g., Omni Capital Int'l, Ltd. v. Rudolf Wolff & Co., Ltd.*, 484 U.S. 97, 111 (1987). Indeed, the rulemaking process is the more appropriate venue for instituting policy-based

amendments to the Federal Rules. *Mohawk Indus., Inc. v. Carpenter*, 558 U.S. 100, 130 S.Ct. 599, 609 (2009). That is especially true when, as here, the public policy arguments presume wide-ranging empirical facts, see Lumen N. Mulligan & Glen Staszewski, *The Supreme Court's Regulation of Civil Procedure: Lessons from Administrative Law*, 59 UCLA L. REV. 1188, 1217 (2012), and achieving policy goals may require amendment to several rules simultaneously. Catherine T. Struve, *The Paradox of Delegation: Interpreting the Federal Rules of Civil Procedure*, 150 U. PA. L. REV. 1099, 1120–24 (2002).

II.B. Moreover, Congress has enacted significant reforms to the procedures governing securities fraud class actions while leaving Rule 23 untouched. *See* Mary K. Kane, et al., *Federal Practice & Procedure* §1806 (2012). Congress is the quintessential policy-making body, and in a better position to consider any further reforms that Petitioners hope to propose.

ARGUMENT

I. THIS IS A FEDERAL RULES OF CIVIL PROCEDURE CASE, NOT A SECURITIES LAW PUBLIC POLICY DEBATE.

Fundamentally, this is a case about *procedure*. Petitioners are in the wrong forum for a securities law public policy debate. As the District Court and the Court of Appeals correctly concluded, this case begins and ends with the interpretation of Federal Rule of Civil Procedure 23(b)(3).

Petitioners, however, invite this Court to act as a quasi-Congress and resolve public policy debates regarding the scope and substance of the federal securities laws. Indeed, a substantial portion of Petitioners' opening brief is consumed not with matters of procedure, but policy arguments about the securities laws. *See Pet. Br.* at 13–19 (a "primer" on securities law), *id.* at 24–30 (discovery-based policy concerns), *id.* at 30–34 (economic theories).

The question the Court must resolve here is both narrow and clear: Have the putative class plaintiffs satisfied the requirements of Rule 23(b)(3) in light of this Court's most recent Rule 23 cases such as *Erica P. John Fund v. Halliburton*, 131 S.Ct. 2179 (2011), and *Wal-Mart Stores, Inc. v. Dukes*, 131 S.Ct. 2541 (2011)? The answer is emphatically yes.

A. This Case Turns On The Interpretation Of Rule 23(b)(3).

1. *The Text of 23(b)(3) Does Not Support Petitioners' Interpretation Of The Rule.*

Petitioners' many public policy arguments, unmoored as they are from the text of Rule 23, are irrelevant to the class certification question facing the Court. In fact, Petitioners' public policy arguments

have no place in the interpretation of Rule 23(b)(3) in a judicial forum. *See infra* Part II. To the contrary, this Court uniformly holds that Federal Rules questions are to be treated as matters of statutory interpretation, giving "the Federal Rules of Civil Procedure their plain meaning, and generally with them as with a statute, when we find the terms unambiguous, [the] judicial inquiry is complete." *Pavelic & LeFlore v. Marvel Entm't Group*, 493 U.S. 120, 123 (1989) (internal citations and quotations omitted).

Moreover, Rule 23 is "as binding as any statute duly enacted by Congress, and federal courts have no more discretion to disregard the Rule['s] mandate than they do to disregard constitutional or statutory provisions." *Bank of Nova Scotia v. United States*, 487 U.S. 250, 255 (1988); *see also* FED. R. CIV. P. 1 (Federal Rules "*govern* the procedure in the United States district courts in all suits of a civil nature") (emphasis added); Catherine T. Struve, *The Paradox of Delegation: Interpreting the Federal Rules of Civil Procedure*, 150 U. PA. L. REV. 1099, 1141–52 (2002) (the Court is more constrained in interpreting the Rules than in interpreting statutes because the Rules Enabling Act strictly limits Rule amendment to the formal rulemaking process).

Petitioners' only purported textual argument, *Pet. Br.* at 19–24, rests upon a faulty two-prong construction of Rule 23(b)(3)'s requirement that a district court must "find" "that the questions of law or fact common to class members predominate over any questions affecting only individual members." FED. R. CIV. P. 23(b)(3). Petitioners argue that Rule 23(b)(3) "predominance" requires district courts to make *two* distinct findings, but Petitioners are only half-correct. First, Petitioners rightly contend that

Rule 23(b)(3) requires the court to find the case susceptible to common answers to central issues in the suit. *Pet. Br.* at 21. But Petitioners then fabricate a second directive: that the court also find the plaintiff class will prevail *on the merits* of the questions that "predominate." *Id.* at 22.

The second part of Petitioners' interpretation is nowhere in the text of Rule 23(b)(3). Nowhere does the Rule require that the district court resolve the predominate questions *in plaintiffs' favor* or otherwise adjudicate the merits. In fact, the Rule's very use of the term "common questions," as opposed to any sort of "merits" indicative terminology, emphasizes that Rule 23 addresses preliminary considerations only, leaving the merits for later adjudication.

The Seventh Circuit rejected Petitioners' proposed reading in *Szabo v. Bridgeport Machines*, 249 F3d 672, 677 (7th Cir. 2001)—a case this Court cited with approval in *Wal-Mart*, 131 S.Ct. at 2552—holding that Rule 23 precludes district courts from adopting the analysis that "I'm not going to certify a class unless I think that the plaintiffs will prevail." *See also Bertrand ex rel. Bertrand v. Maram*, 495 F3d 452, 455 (7th Cir. 2007) (similar).

Petitioners attempt to evade Rule 23(b)(3)'s text by arguing that the Court has approved the practice of district courts considering merits issues during the class certification stage in instances where the certification and merits questions overlap. *See Pet. Br.* at 35–37. Further, Petitioners appear to argue that fraud-on-the-market cases are unique because Rule 23(b)(3) predominance is proved by class-wide reliance upon false statements made in a well-functioning market. *Pet. Br.* at 21.

Amici do not dispute that a "peek" at the merits may be appropriate in some cases, but Petitioners go off the rails when they ignore the strict limitations of that doctrine. In reality, Petitioners do not want merely a "preview" of the movie; they want the district court to actually watch the movie itself. That approach improperly transforms a legitimate "peek" to ensure that common questions predominate into a decision *on the merits* at the class certification stage.[2]

The Official Comments to the 2003 Rule 23 revisions emphasize the limited purpose of a "peek":

> Although an evaluation of the probable outcome on the merits is not properly part of the certification decision, discovery in aid of the certification decision often includes information *required to identify the nature of the issues that actually will be presented at trial.* In this sense it is appropriate to conduct controlled discovery into the "merits," *limited to those aspects relevant to making the certification decision on an informed basis.* . . . A critical need is to determine how the case will be tried. An increasing number of courts require a party request-

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[2] It is clear that the 1966 revisions that produced, by and large, the current version of Rule 23(b)(3) envisioned cases precisely such as this one as archetypal class actions:

> The court is required to find, as a condition of holding that a class action may be maintained under this subdivision [(b)(3)], that the questions common to the class predominate over the questions affecting individual members. It is only where this predominance exists that economies can be achieved by means of the class-action device. In this view, *a fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action*, and it may remain so despite the need, *if liability is found*, for separate determination of the damages suffered by individuals within the class. On the other hand, although having some common core, a fraud case may be unsuited for treatment as a class action if there was material variation in the representations made or in the kinds or degrees of reliance by the persons to whom they were addressed.

FED. R. CIV. P. 23, Official cmts. (1966) (emphasis added). Here, just as the Committee comment envisioned, the plaintiffs' allegation is that Petitioners made the *very same* fraudulent misrepresentations to *all* members of the class.

> ing class certification to present a "trial plan" that describes the issues likely to be presented at trial and *tests whether they are susceptible of class-wide proof.*

FED. R. CIV. P. 23, official cmts. (2003) (emphasis added). Indeed, the Advisory Committee made clear that any "peek" at the merits is legitimate only if such a review will assist the district court in analyzing the requirements of Rule 23 itself.

The Committee did not sanction (much less require) a merits resolution of predominate questions at certification. Rather, the Committee contemplated a very truncated merits review, and even then only for a limited purpose: to ensure that predominant issues may be resolved with class-wide proof. Any other approach contravenes Rule 23's text, which simply mandates that the district court "find" that common questions "predominate" among the putative class – not that the questions will be resolved in favor of either side on the merits.

2. *Petitioners' Interpretation Runs Afoul Of The "Common Answers" Principle Of* Wal-Mart Stores, Inc. v. Dukes.

Petitioners' textually unmoored suggestion that the district court must determine "materiality" ignores the lesson of *Wal-Mart Stores, Inc. v. Dukes*: what matters in the certification process is whether the suit involves class-wide *common answers*.[3] Petitioners' approach, in contrast, seeks to add another requirement—that the common answers must favor the putative class, a position that goes well beyond *Wal-Mart*'s holding.

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[3] *Amici* agree with Petitioners that *Wal-Mart*'s discussion of Rule 23(a)'s "common contention" language is germane to the Rule 23(b)(3) analysis of "predominate," because an issue must be common before it can predominate. *See Pet. Br.* at 36 n.6.

The Court in *Wal-Mart* clarified that a putative class cannot raise common questions by the mere assertion that all class members seek redress under the same federal statute, or that they all assert similar injuries. *Wal-Mart* 131 S.Ct. at 2551. Rather, the putative class must show that "claims ... depend upon a common contention," a more contextual assertion than merely collective reliance upon the same federal statute for a cause of action. *Id.* Moreover, the common contention must be susceptible of a common resolution:

> What matters to class certification is not the raising of common questions even in droves but, rather the capacity of a classwide proceeding to generate common answers apt to drive the resolution of the litigation. Dissimilarities within the proposed class are what have the potential to impede the generation of common answers.

Id. at 2551 (quoting Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. REV. 97, 132 (2009) (internal quotations omitted)).

Thus, Rule 23 requires "a common contention...[that is] of such a nature that it is capable of classwide resolution—which means that determination of its truth *or falsity* will resolve an issue that is central to the validity of each one of the claims in one stroke." 131 S.Ct. at 2551 (emphasis added). To certify a class, the district court must affirmatively "*find*," not merely accept as pleaded, that resolution of a central issue is susceptible to a *common answer*. *Id.* at 2552. In this regard, *amici* agree with Petitioners that district courts must rigorously review certification motions to ensure conformity with the Rule 23 "common contention" and "predominate" requirements, and "find" that central issues are amenable to resolution by common answer. *See Pet. Br.* at 19–21.

What Petitioners ignore, however, is that this Court specifically excluded the ultimate determination of common answers from the certification analysis. At the certification stage, a district court is only to "find" that a common answer will exist, not that such an answer will be favorable to one side or the other: a district court should not determine the "truth or falsity" of predominate questions at the certification stage. *Wal-Mart* 131 S.Ct. at 2551. *See also id.* at 2551 n. 6; *Gen. Tel. Co. of the S.W. v. Falcon*, 457 U.S. 147, 160 (1982) (district court must conduct a "rigorous analysis" of Rule 23 factors at the certification stage, but only to ensure Rule 23 requirements are met); *Coopers & Lybrand*, 437 U.S. at 469 & n.12 (even if Rule 23 determinations relate to merits questions, district courts are not authorized to resolve matters beyond the scope of Rule 23 at the certification stage).[4]

Petitioners are wrong to suggest that *Wal-Mart* goes further and requires district courts to make a

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[4] The courts of appeals similarly have approved of a limited merits review at certification, but only to determine "whether those elements will be subject to class-wide proof." *Williams v. Mohawk Indus., Inc.*, 568 F.3d 1350, 1358 (11th Cir. 2009). *See also Schleicher*, 618 F.3d at 685 ("Although we concluded in *Szabo v. Bridgeport Machines, Inc.*, 249 F.3d 672 (7th Cir. 2001), that a court may take a peek at the merits before certifying a class, *Szabo* insisted that this peek be limited to those aspects of the merits that affect the decisions essential under Rule 23."); *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 318 (3d Cir. 2008) ("In reviewing a motion for class certification, a preliminary inquiry into the merits is sometimes necessary to determine whether the alleged claims can be properly resolved as a class action."); *In re Initial Public Offering Sec. Litig.*, 471 F.3d 24, 38–41 (2d Cir. 2006) (a district court may consider merits issues, but only insofar as they speak directly to a Rule 23 requirement).

merits determination in the putative class's favor. Rather, Petitioners' defense that the statements were immaterial—an argument that if successful would impact all members of the putative class uniformly—demonstrates that the "materiality" answer will be common to all, regardless of who wins, and that is all Rule 23(b)(3) requires in order to establish predominance. 131 S.Ct. at 2551.[5]

B. This Court's Decision In *Erica P. John Fund v. Halliburton Co.* Is A Roadmap For Affirmance.

1. This case is on a par with *Erica P. John Fund v. Halliburton*, 131 S.Ct. 2179 (2011). As in that case, "the sole dispute here is whether [plaintiff] satisfied the prerequisites of Rule 23(b)(3)." *Id.* at 2184. Thus, "[i]n order to certify a class under that Rule, a court must find" that questions of law or fact predominate as to the members of the class. *Id.* Further, deter-

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[5] The Rule 23(b)(3) predominance standard might be compared to the hypothetical of a birdwatcher who spots a flock of birds but forgot his Peterson's field guide at home. The amateur ornithologist observes that the birds are small in size, orange breasted, black beaked, and possess white striping on their wings. Even if unable to be sure of their species, our birdwatcher could readily "certify" or "find" that the birds are all of a common flock, and thus his ultimate identification of the birds is susceptible of a uniform answer in "one stroke," once he returns home and can review definitive sources.

In this case, however, Petitioners would require a district judge to make a positive determination of merits issues while still "in the field" and without essential evaluative tools. That is not the way that Rule 23 directs a district judge to proceed. Like the ornithologist, a district judge simply needs to "find" that common issues "predominate" and will be susceptible of "common answers." Ultimately, Petitioners' proposed interpretation of Rule 23(b)(3) does not fly (unlike the unidentified birds), either as a textual matter or as an application of the "common answers" principle of *Wal-Mart*.

mining whether common questions (and thus common *answers* under *Wal-Mart*) "predominate," "begins, of course, with the elements of the underlying cause of action." *Id.* at 2184.[6]

Halliburton recognized that "[w]hether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance." 131 S.Ct. at 2184. In *Halliburton*, however, as in this case, the defendants argued that the class also had to prove an additional element of a securities fraud claim—there it was "loss causation"—at the certification stage. *Id.* The Court rejected that claim, just as it should reject the Petitioners' claim here that "materiality"—the first element of a securities fraud claim—must be *proved* at certification.

In *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), the Court held that class plaintiffs could invoke a "fraud-on-the-market" presumption of reliance, if certain conditions are met. *Basic* did not require plaintiffs to prove materiality as a prerequisite for class certification (in fact the Court affirmed the district court's order certifying the class there while remanding the summary judgment decision to consider the materiality question). But Petitioners here seek to add proof of materiality as a prerequisite to class certification, contrary to *Basic*. *Cf. Halliburton*, 131 S.Ct. at 2185 ("the Court of Appeals" held that "EPJ Fund also had

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[6] The "elements of a private securities fraud claim based on violations of §10(b) and Rule 10b-5 are: (1) a material misrepresentation ... by the defendant: (2) scienter; (3) a connection between the misrepresentation ... and the purchase or sale of a security; (4) reliance upon the misrepresentation ...; (5) economic loss; and (6) loss causation." 131 S.Ct. at 2184 (citing *Matrixx Initiatives*, 131 S.Ct. at 1317 (quoting *Stoneridge Investment Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 157 (2008))).

to establish loss causation at the certification stage to trigger" the *Basic* presumption).

Just, as it did in *Halliburton*, however, the Court should reject that invitation because such a "requirement is not justified by *Basic* or its logic." *Id.* Materiality, like loss causation, "addresses a matter different from whether an investor relied on a misrepresentation, presumptively or otherwise, when buying or selling a stock." *Id.* at 2186; *Greenberg v. Crossroads Sys., Inc.*, 364 F.3d 657, 664 (5th Cir. 2004) ("The fraud-on-the-market presumption addresses reliance, not materiality, and the two elements are fundamentally different.")

Indeed, here, Petitioners already tested the sufficiency of plaintiffs' allegation of materiality and lost, when the District Court denied Petitioners' Rule 12(b)(6) motion. To permit defendants who have lost on 12(b)(6) grounds to compel the plaintiffs *to prove* "materiality" at the class certification stage (as opposed to testing that at summary judgment) is contrary to the overall scheme of the Federal Rules, as *Halliburton* recognized. Moreover, the PSLRA imposes heightened pleading standards on securities fraud actions, and those "[h]eightened pleading standards in securities fraud actions ... contribute to a 39.1% dismissal rate at [the Rule 12(b)(6)] litigation phase." Elizabeth Chamblee Burch, *Securities Class Actions as Pragmatic* Ex Post *Regulation*, 43 GA. L. REV. 63, 79 (2008).

Thus, as in *Halliburton*, there is no justification for construing Rule 23(b)(3) to impose a trial-like "proof" requirement with respect to inquiries that do not pertain to the Rule 23 analysis. Indeed, like "loss causation," "materiality" "has no logical connection to the facts necessary to establish the efficient market

predicate to the fraud-on-the market theory." 131 S.Ct. at 2186. Thus, "a complaint must support allegations of falsehood and *scienter* in the way required by the PSLRA ..., but proof can await motions for summary judgment and trial." *Schleicher*, 618 F.3d at 687–88.

2. This Court recently recognized that "[p]erhaps the most common example of considering a merits question at the Rule 23 stage arises in class-action suits for securities fraud" because "each of the individual investors would have to prove reliance on the alleged misrepresentation." *Wal-Mart*, 131 S.Ct. at 2552 n.6. But, the Court expressly noted that "the problem dissipates if the plaintiffs can establish the applicability of the so-called 'fraud on the market' presumption ...." *Id.* And nothing in *Wal-Mart* indicates that other elements of a securities fraud claim, *e.g.*, materiality, *scienter*, or economic loss, should be imported into the fraud on the market presumption analysis.

Just as in *Halliburton*, Rule 23(b)(3)'s requirement that a court "find" that common questions predominate does not bear the load that Petitioners seek to impress upon it here. Rather, "whether statements were false, or whether the effects were large enough to be called material, are questions on the merits." *Schleicher*, 618 F.3d at 685. Importantly in light of the Court's focus in *Wal-Mart* on "common answers," it is decisive that "[f]alsehood and materiality affect investors alike...." *Id.* at 685.

Thus, the Federal Rules certainly contemplate that it "is possible to certify a class under Rule 23(b)(3) even though all statements turn out to have only trivial effects on stock prices. Certification is appropriate, but the class will lose on the merits." *Schlei-*

cher, 618 F.3d at 685; *see also id.* ("Under the current rule [23(b)(3),] certification is largely independent of the merits ... and a certified class can go down in flames on the merits"); *id.* at 686 ("Rule 23 allows certification of classes that are fated to lose as well as classes that are sure to win."); *id.* at 687 ("The chance, even the certainty, that a class will lose on the merits does not prevent its certification."). Indeed, "whether a statement is materially false is a question common to all class members and therefore may be resolved on a class-wide basis after certification." *Schleicher*, 618 F.3d at 687.

Ultimately, the determination whether any misrepresentations were material is a question *on the merits* of a plaintiff's claim, a determination inappropriate for final resolution when a district court is applying Rule 23(b)(3). As it did in *Halliburton*, the Court should reject Petitioners' invitation to import additional elements of a securities fraud claim into the Rule 23(b)(3) analysis.

II. PETITIONERS' DISAGREEMENTS WITH CURRENT LAW ARE BETTER DIRECTED ELSEWHERE.

This Court is not the appropriate forum to weigh Petitioners' purported concerns about securities class actions generally, nor the multitude of policies that may bear on the substance of federal securities laws. First, under the auspices of this Court, there is an elaborate rulemaking process available for amending the Rules of Civil Procedure, a process in which Congress plays a role. Second, Congress itself may act directly to alter the law governing securities fraud and class action litigation, just as it has done on several occasions in recent years. Thus, Petitioners are

hardly without a forum in which to press their public policy arguments about federal securities law.

In light of these avenues, it would not be "appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits." *Schleicher*, 618 F.3d at 686.

A. The Federal Rulemaking Process Is The Better Venue For Evaluating Petitioners' Public Policy Concerns

1. Petitioners frame their argument primarily as one of substantive securities-law policy, with only a scant five pages of their brief speaking to Rule 23(b)(3) *per se*. *See Pet. Br.* at 19–24. Petitioners seem to believe that only when policy is in doubt should one resort to the text of Rule 23(b)(3).[7] Given the binding nature of Rule 23(b)(3)'s text, however, Petitioners' pure policy arguments untethered to the text of the Rule necessarily fail.

In *Omni Capital Int'l, Ltd. v. Rudolf Wolff & Co., Ltd.*, 484 U.S. 97 (1987), the Court faced a similar argument about a Federal Rule of Civil Procedure, where the question was whether a defendant was subject to service of process when Rule 4 did not authorize service in the circumstances presented. *Id.* at 101–02. The Court considered whether it could nevertheless judicially craft a service rule because such a rule would further important public policy goals. *Id.* at 108. The Court emphatically "decline[d] to embark on that adventure," even while also acknowl-

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[7] *Cf.* Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COL. L. REV. 527, 543 (1947) ("to give point to the quip that only when legislative history is doubtful do you go to the statute").

edging that a new service rule could "well serve the ends of the CEA and other federal statutes." *Id.* at 111. In so holding, the Court put policy arguments aside: "It is not for the federal courts ... to create such a rule, ... That responsibility, in our view, better rests with those who propose the Federal Rules of Civil Procedure and with Congress." *Id. Cf. Coopers & Lybrand v. Livesay*, 437 U.S. 463, 477 (1978) (rejecting the policy argument "that an interlocutory order may induce a party to abandon his claim before final judgment," as an insufficient reason to abandon a plain-text approach to the interpretation of "'final decision' within the meaning of § 1291.").

2. Instead, as this Court has often noted, the rulemaking process is the appropriate setting for considering policy-based amendments to the Federal Rules of Civil Procedure. This case is certainly an instance in which change, if any is needed, is better achieved by the rules process.

As the Court has made clear, "the rulemaking process has important virtues. It draws on the collective experience of bench and bar, see 28 U.S.C. § 2073, and it facilitates the adoption of measured, practical solutions." *Mohawk Indus., Inc. v. Carpenter*, 558 U.S. 100, 130 S. Ct. 599, 609 (2009). In addition, the rulemaking process has numerous institutional advantages. "[T]he Advisory Committee on Civil Rules can collect and process information, assess global effects, and compare different . . . options, [in addition to] invit[ing] public participation by holding hearings and soliciting written input." Robert G. Bone, *Plausibility Pleading Revisited and Revised: A Comment on* Ashcroft v. Iqbal, 85 NOTRE DAME L. REV. 849, 884 (2010).

Moreover, policy change via rulemaking may better comport with congressional intent than does Federal Rules policy change by judicial decision. *See Swint v. Chambers Cnty Comm'n*, 514 U.S. 35, 48 (1995) (recognizing a congressional preference for rulemaking in the context of the finality rule for appellate jurisdiction); Struve, 150 U. PA. L. REV. at 1141–52 (arguing that the terms of delegated rulemaking authority in the Rules Enabling Act limit Rule amendment power to the rulemaking process). Furthermore, Congress itself plays an important role in the rulemaking process. *See* 28 U.S.C. § 2074(a) (2006). Finally, the Court is not alone in recognizing the virtues of rulemaking over adjudication in resolving policy matters—the vast weight of scholarly authority endorses the Court's view as well.[8]

Here, Petitioners are making broad empirical claims about securities law, discovery, settlements, and economic theory. *See Pet. Br.* at 13–19 (a "primer" on securities law), *id.* at 24–30 (discovery-based policy concerns), *id.* at 30–34 (economic theories).

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[8] *See, e.g.*, Kevin M. Clermont & Stephen C. Yeazell, *Inventing Tests, Destabilizing Systems*, 95 IOWA L. REV. 821, 850 (2010) (arguing that Federal Civil Rules issues that have ramifications across multiple rules are better resolved by the Civil Rules Advisory Committee); Robert G. Bone, *The Process of Making Process: Court Rulemaking, Democratic Legitimacy, and Procedural Efficacy*, 87 GEO. L.J. 887, 889 (1999) ("[A] centralized, court-based, and committee-centered process is well suited for making general constitutive rules that define the basic framework of a civil procedure system and more detailed rules that control particularly costly forms of strategic behavior."); Paul D. Carrington, *"Substance" and "Procedure" in the Rules Enabling Act*, 1989 DUKE L.J. 281, 282 (arguing that the technical nature of the promulgation of judicial rules cannot sustain interest through typical political channels and should be left to the formal advisory committee process).

Whether Petitioners' policy arguments are sound largely depends upon matters such as statistical rates of settlement in class-action suits after certification and similar determinations. "Notice-and-comment rulemaking ... is well suited to accurately determining legislative facts" of this type, especially as compared to the institutional capacity of appellate litigation of individual cases. Lumen N. Mulligan & Glen Staszewski, *The Supreme Court's Regulation of Civil Procedure: Lessons from Administrative Law*, 59 UCLA L. REV. 1188, 1217 (2012). Additionally, Petitioners' interpretation of Rule 23 could well interact with pleading standards under the Rules and the PSLRA, and the summary judgment standard, to name just a few examples of interrelatedness of the Rules. The interconnected nature of the rules, therefore, strongly favors a rulemaking approach to reform, if reform is to be had. *See* Struve, 150 U. PA. L. REV. at 1120–24.

The Court should sharply discount, if not disregard altogether, Petitioners' many naked policy arguments, arguments that are better presented to the Civil Rules Advisory Committee or to Congress directly. *See Omni Capital,* 484 U.S. at 111; Mulligan & Staszewski, 59 UCLA L. REV. at 1215–34.

3. Another flaw in Petitioners' policy-based justification for amending Rule 23(b)(3) is that their arguments are specific to fraud-on-the-market cases. Rule 23, however, is a general *procedural* rule, not a rule that varies based on the whether the lawsuit is a securities fraud action, as here, an employment discrimination case (*Wal-Mart*), an antitrust action (*Comcast Corp. v. Behrend*, No. 11-864), or involves any other particular substantive area of the law.

Instead, Rule 23 "creates a categorical rule entitling a plaintiff whose suit meets the specified criteria to pursue his claim as a class action." *Shady Grove Orthopedic Associates, P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 1437 (2010); *see Ashcroft v. Iqbal*, 556 U.S. 662, 684 (2009) (rejecting the notion that *Twombly*'s interpretation of Rule 8(a)(2) applies only to complex anti-trust cases: "Rule [8(a)(2)] in turn governs the pleading standard in all civil actions .... Our decision in *Twombly* expounded the pleading standard for all civil actions.")

Ultimately, Petitioners fail to present arguments that speak to class certification generally. Instead, Petitioners start from the faulty premise that this Court should and will adopt different readings of Rule 23(b)(3) for cases involving different subject matters. Such a result would be irreconcilable with the well-established principle that the Rules are trans-substantive. The Court must reject Petitioners' invitation to go down that garden path in the guise of interpreting the text of Rule 23.

B. Congress Already Has Taken An Active Role In Reforming Securities Fraud And Class Action Law.

Congress has been receptive to public policy arguments about securities and class action law. For example, in 1995, Congress enacted the PSLRA, which imposed several significant new requirements on securities fraud actions, particularly class actions. In 1998, Congress enacted the Securities Litigation Uniform Standards Act, Pub. L. No. 105-353, 112 Stat. 3227, to require that securities fraud class actions of any significant size be brought and resolved in federal rather than state court, a forum in which federal rules would control the litigation. Finally, in 2005

Congress enacted the Class Action Fairness Act, Pub. L. No. 109-2, 119 Stat. 4 (2005). See *Std. Fire Ins. Co. v. Knowles*, No. 11-1450, *cert. granted* (Aug. 31, 2012) (addressing whether a plaintiff may evade the CAFA by stipulating that damages are less than the threshold for federal jurisdiction).

Thus, "Congress has been concerned about the potential for class certification to create pressure for settlement...." *Schleicher*, 618 F.3d at 686. In addressing that issue, "Congress chose to deal with settlement pressure ... [by] requir[ing] more at the pleading stage and ... [by] ensur[ing] that litigation occurs in federal court under these special standards, rather than state court under looser ones." *Id.*

Indeed, in 1998, "Congress enacted legislation that bars class-action lawsuits in state courts involving securities traded on national markets." *Federal Practice & Procedure* §1806, at n.2. Importantly, this Court then "held that the 1998 Act applies broadly to pre-empt state-law class-action claims brought by holders of securities, as well as by purchasers and sellers of securities, alleging fraudulent misrepresentation of stock prices." *Id.* at n.2.1. (citing *Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006)). "Thus, most all national securities class actions now must be filed in federal courts where they are subject to the 1995 Reform Act." *Id.*

In 1995, the PSLRA imposed significant new requirements for securities fraud class actions in particular. Among them were the following: (1) a provision that each plaintiff seeking to serve as a representative party must file a sworn certified statement with the complaint that includes a number of assurances and disclosures; (2) new procedures and criteria for appointing a lead plaintiff for the class, with a

strong preference for institutional investors to serve in that role; and (3) significant provisions regarding settlement agreements, including limitations on sealed agreements and attorney's fees, and what must be included in settlement notices. *Federal Practice & Procedure* §1806.

Ultimately, Petitioners' real complaint is that, in their view, Congress has not gone far enough in restricting securities fraud class actions. But the fact that Congress has addressed public policy arguments about this area of law in recent years is yet another reason this Court should decline Petitioners' invitation to take up the public policy debate in the guise of interpreting Rule 23, the text of which clearly bars Petitioners' proposed interpretation.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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AMICUS CURIAE BRIEF

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IN THE

Supreme Court of the United States

AMGEN, INC., *et al.*,

Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF AMICUS CURIAE PUBLIC CITIZEN, INC., IN SUPPORT OF RESPONDENT

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INTEREST OF AMICUS CURIAE[1]

Public Citizen, Inc., a national consumer-advocacy organization founded in 1971, appears on behalf of its members and supporters nationwide before Congress, administrative agencies, and courts on a wide range of issues, and works for enactment and enforcement of laws protecting consumers, workers, and the public. Public Citizen often represents the interests of its members in litigation and as amicus curiae.

Public Citizen believes that class actions are a critically important tool for seeking justice where defendants have engaged in the same or similar unlawful conduct toward many people—investors, consumers, and employees especially—that has resulted in injuries that are large in the aggregate, but are less cost-effective to redress individually. In that situation, class actions offer the best means for both individual redress and classwide remedies, as well as deterrence of wrongful conduct, while simultaneously serving the interests of defendants in achieving definitive and binding resolution of claims against them on the broadest possible basis consistent with the requirements of due process. Class actions have historically played a vital role in civil rights cases, consumer cases, and, of particular relevance here, securities fraud cases.

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[1] Written consents from both parties to the filing of amicus curiae briefs in support of either party are on file with the Clerk. This brief was not authored in whole or in part by counsel for a party. No person or entity other than amicus curiae or its counsel made a monetary contribution to the preparation or submission of this brief.

At the same time, Public Citizen has long recognized that class actions may be misused, to the detriment of absent class members as well as defendants. Public Citizen attorneys have, in many cases, represented class members whose rights have been compromised by the improper certification of classes and the approval of settlements that are not in their interests or that have been entered into without respect for such due process entitlements as the right of absent class members to receive notice and to opt out.

The interests of both named and absent class members, defendants, the judiciary, and the public at large are best served by adherence to the principles incorporated in Federal Rule of Civil Procedure 23. Those principles are in turn informed both by the Due Process Clause and by the considerations of fairness and efficiency that led to the creation of the modern version of Rule 23 in 1966 and to the many refinements of the Rule that have occurred since then. Public Citizen has sought to advance this view by participating, either as lead counsel, co-counsel, or amicus curiae in many of this Court's decisions that are relevant to the issues posed by this case, including *Shady Grove Orthopedic Associates v. Allstate Insurance Co.*, 130 S. Ct. 1431 (2010), *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997), *Smith v. Bayer Corp.*, 131 S. Ct. 2368 (2011), and *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011). Public Citizen believes that the submission of this brief may similarly be helpful to the Court in resolving this case.

SUMMARY OF ARGUMENT

Amgen's argument that certification of a plaintiff class in a securities fraud case premised on the fraud-on-the-market theory of recovery requires proof that the misrepresentations at issue were material rests on a fundamental error: It confuses the issue of whether common questions *predominate* with the issue of whether the plaintiffs will *prevail* on those common questions. Under Federal Rule of Civil Procedure 23(b)(3), a showing that common questions predominate—not proof that the plaintiffs will prevail on them—is the touchstone of class certification. In a fraud-on-the-market case, once it is established that the securities at issue are traded in an efficient market, the materiality of the claimed misrepresentations *is* one of the common questions that predominate. Plaintiffs in such a case do not have to prove that they will win on that question to establish that it and the other common issues present in a fraud-on-the-market case predominate over individual questions.

Amgen's contrary position rests less on the terms of Rule 23 and the case law construing it than on considerations of policy: Amgen contends that imposing a heavier burden on plaintiffs seeking to certify securities fraud class actions is necessary to redress disadvantages to defendants that Rule 23's operation would otherwise perpetuate. But it is Amgen's position that would have adverse effects not only on plaintiffs, but also on the courts and even on the defendants Amgen seeks to protect. By requiring plaintiffs to prove, at the certification stage, parts of their case that are not necessary to establish the existence or predominance of common questions, adoption of Amgen's view would multiply the extent and costs of precertification

discovery, and would burden both courts and parties with what would amount to two trials on the merits of each case.

Moreover, by substantially increasing the burden of precertification proceedings and the stakes of the certification decision, Amgen would perversely increase the settlement pressure exerted on defendants by both uncertified and certified class actions. And by shifting the determination of the question of materiality from the merits stage of the case to the certification stage, Amgen would, ironically, ensure that even in a case where a defendant prevailed on the materiality issue, it would not secure a resolution of that common question that would bind members of the putative class and thereby protect the defendant against successive suits.

In short, Amgen offers neither a faithful reading of Rule 23 nor a sound approach to vindicating the fundamental purposes of the Rule—providing a fair and efficient means of resolving common issues affecting large groups of litigants.

ARGUMENT

I. In a Fraud-on-the-Market Case, Materiality Is Not a *Prerequisite* to Class Certification, but One of the Common Questions That the Class Is Certified to Resolve.

Federal Rule of Civil Procedure 23 sets forth in detail the requirements that an action must meet to be certified as a class action. Absent a congresssional decision to exclude a particular type of claim from the operation of Rule 23, *any* action meeting the Rule's requirements is eligible for class certification. *Shady Grove Orthopedic Assocs. v. Allstate Ins. Co.*, 130 S.

Ct. 1431, 1438 (2010). A court must certify a class if, and only if, it is "satisfied, after a rigorous analysis, that the prerequisites of [the Rule] have been satisfied." *Gen. Tel. Co. of SW v. Falcon*, 457 U.S. 147, 161 (1982). That determination "generally involves considerations that are 'enmeshed in the factual and legal issues comprising the plaintiff's cause of action.'" *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 469 (1978) (citation omitted). Thus, a court considering certification may not avoid the determinations required by Rule 23 merely because they may overlap to some extent with the merits of the plaintiffs' claims. *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551-52 (2011). Nonetheless, the plaintiffs' burden at the certification stage is not to show that they will prevail on the merits, but only to "demonstrate ... compliance with the rule." *Id.* at 2551.

Rule 23's requirements for certification are set forth in the first two subsections of the Rule, (a) and (b). Rule 23(a) provides that plaintiffs seeking to represent a class must show that:

> (1) the class is so numerous that joinder of all members is impracticable;
>
> (2) there are questions of law or fact common to the class;
>
> (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and
>
> (4) the representative parties will fairly and adequately protect the interests of the class.

In addition to these four prerequisites, generally referred to as "numerosity," "commonality," "typicality," and "adequacy of representation," *see Shady*

Grove, 130 S. Ct. at 1437, the plaintiffs must also demonstrate that they meet the criteria of one of the three subdivisions of Rule 23(b). Those subdivisions, respectively, authorize certification of classes in cases where individual litigation would lead to inconsistent adjudications or otherwise impair the rights of absent parties (Rule 23(b)(1)), where classwide injunctive or declaratory relief is appropriate (Rule 23(b)(2)), or where "the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy" (Rule 23(b)(3)).

If the plaintiffs succeed in showing satisfaction of the Rule 23(a) prerequisites and the requirements of one of the subdivisions of Rule 23(b), then, in the words of Rule 23(b), "[a] class action may be maintained." As this Court has explained, "[b]y its terms this [language] creates a categorical rule entitling a plaintiff whose suit meets the specified criteria to pursue his claim as a class action." *Shady Grove*, 130 S. Ct. at 1437. "Rule 23 unambiguously authorizes *any* plaintiff, in *any* federal civil proceeding, to maintain a class action if the Rule's prerequisites are met." *Id.* at 1442.

In case like this one, in which certification is sought under Rule 23(b), the key issues are *predominance* of common questions over issues requiring individual adjudication, and *superiority* of the class action over individual litigation as a means for resolving those common questions. The common questions that must predominate are the same "questions of law or fact common to the class" whose existence satisfies

the Rule 23(a)(2) commonality prerequisite to certification. As this Court has explained, a putative class's claims present a common question within the meaning of the Rule when the "claims ... depend upon a common contention" that is "of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." *Wal-Mart*, 131 S. Ct. at 2551. Rule 23(b)(3)'s inquiry into whether such claims predominate, in turn, "tests whether proposed classes are sufficiently cohesive to warrant adjudication by representation." *Amchem Prods, Inc. v. Windsor*, 521 U.S. 591, 623 (1997).

The identification of common questions and the determination whether those questions predominate depend on the substantive law applicable to claims for which class treatment is sought. *See, e.g., Wal-Mart*, 131 S. Ct. at 2551-52. In this case, the relevant principles of substantive law are the criteria for the assertion of a fraud-on-the-market claim under Rule 10b-5 established in this Court's decision in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), and its progeny.

Importantly, the elements of a fraud-on-the-market claim are *not* additional criteria for class certification beyond those set forth in Rule 23: Rule 23 remains the "one-size-fits-all formula for deciding the class-action question," *Shady Grove*, 130 S. Ct. at 1437, and that formula is applicable to fraud-on-the-market claims no less (and no more) than to any other claim brought in a federal court. Nor do the elements of a fraud-on-the-market claim somehow emanate from Rule 23, making them applicable only in class actions. The terms of the Rules Enabling Act, 28

U.S.C. § 2072, make clear that Rule 23, like other valid rules of procedure, does not "change plaintiffs' separate entitlements to relief," but "leaves the parties' legal rights and duties intact and the rules of decision unchanged." *Shady Grove*, 130 S. Ct. at 1443 (plurality). In other words, if a class of plaintiffs may recover damages upon proof of a fraud-on-the-market claim, it necessarily follows that each member of the class could likewise "bring a freestanding suit asserting his individual claim" for the damages he suffered. *Id.* (plurality).

Thus, class actions are available in fraud-on-the-market cases not because the fraud-on-the-market theory supplies a procedural standard for certification of a class, but because (and to the extent that) the substantive elements of such a claim provide the common questions that must exist and predominate to allow certification of a class under Rules 23(a) and (b)(3). That is precisely what this Court held in *Basic*. There, the Court first established the viability of the fraud-on-the-market theory as a substantive basis for recovery under Rule 10b-5, set forth the elements (including materiality) required to establish liability under that theory, and established a presumption of reliance upon proof of a material false statement where securities are traded in an efficient market. *See Basic*, 485 U.S. at 230-49. Based upon those holdings, the Court further concluded that the district court had been correct in certifying a class, because, under the substantive legal standard adopted by the Court, the class's claims presented common legal questions that predominated over individual questions. *See id.* at 242, 250.

Specifically, the Court in *Basic* observed that a fraud-on-the-market claim "require[s] resolution of several common questions of law and fact concerning the falsity or misleading nature of ... public statements made by [the defendant], the presence or absence of scienter, *and the materiality of the misrepresentations, if any*." *Id.* at 242 (emphasis added). Absent the presumption of reliance afforded by the fraud-on-the-market doctrine, however, these common issues may be "overwhelmed" by the need to prove "individualized reliance [by] each member of the proposed plaintiff class." *Id.*

The *Basic* presumption that individual investors in securities traded in an efficient market rely on material misrepresentations (because such misrepresentations impair the integrity of market prices on which securities investors rely, *see id.* at 244-45), has the effect of overcoming the potential predominance of individual issues that might otherwise bar certification of a class. Under *Basic*, proof of the existence of an efficient market allows the answer to the common question of material falsity also to supply a common answer to the otherwise individual question of reliance. Thus, *Basic*'s substantive holding about the proof required to establish liability in a fraud-on-the-market case also makes possible a procedural finding that common issues predominate in a securities fraud class action if the criterion of an efficient market is present. As this Court explained in *Wal-Mart*:

> Rule 23(b)(3)'s requirement that "questions of law or fact common to class members predominate over any questions affecting only individual members" would often be an insuperable barrier to class certification [in class-action suits for se-

> curities fraud], since each of the individual investors would have to prove reliance on the alleged misrepresentation. But the problem dissipates if the plaintiffs can establish the applicability of the so-called "fraud on the market" presumption, which says that all traders who purchase stock in an efficient market are presumed to have relied on the accuracy of a company's public statements. To invoke this presumption, the plaintiffs seeking 23(b)(3) certification must prove that their shares were traded on an efficient market
>
> ....

131 S. Ct. at 2552 n.6.

Contrary to Amgen's assertion, plaintiffs who have shown the existence of an efficient market need not also prove that misrepresentations were material to establish that common issues predominate for purposes of Rule 23. Materiality is, of course, an element of a fraud-on-the-market claim under *Basic* (as, indeed, it is an element of a securities claim *not* resting on a fraud-on-the-market theory), but its existence is not necessary to show the presence and predominance of common questions of fact or law. Under *Basic*, it is the existence of an efficient market that allows a common, classwide answer to the question of reliance through the answer to the common question of material falsity. *See* 485 U.S. at 243-48. Thus, where an efficient market has been shown to exist, *materiality is one of the central, common questions that predominate* in a securities fraud class action. Plaintiffs need not show that they will prevail on that issue to demonstrate either that it is present or that, together with the other common questions posed by a fraud-on-

the-market claim, it predominates over individual issues.

This conclusion follows directly from *Basic*, where the Court explicitly described materiality as one of the common issues in the case—issues that predominated in light of the Court's ruling that individual reliance need not be affirmatively proved. *Id.* at 242. Thus, *Basic* affirmed the certification of a class even though the materiality of the misrepresentations at issue had *not* been established and the issue remained subject to dispute on remand under the substantive standard established by the Court. *Id.* at 240-41.

Moreover, the materiality issue in a fraud-on-the-market case fits squarely within this Court's definition of a common question: one that "generate[s] common *answers* apt to drive the resolution of the litigation." *Wal-Mart*, 131 S. Ct. at 2551 (citation omitted). In other words, a common question "must be of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." *Id.*

Where the plaintiff has shown an efficient market, the question whether misrepresentations were materially false meets that definition exactly. Because the test of materiality is objective, depending not on the interests of particular investors but on what a "reasonable investor" would consider significant, *see Basic*, 485 U.S. at 232, the question can be, and indeed necessarily must be, answered on a classwide basis. And determining its truth or falsity will resolve an issue central to the validity of each class member's claims in one stroke. If the misrepresentations are material, not only will one element of the class's claim

be established directly, but reliance will also be presumed and a finding of liability to all members of the class will be possible (depending on the resolution of the other common issues that must be proved to establish liability).

If, on the other hand, the claimed misrepresentations are *not* material, the fraud-on-the-market claim of *each* member of the plaintiff class will fail. More than that, a finding of lack of materiality will be fatal to *any* securities fraud claim that *any* individual member of the class may advance based on the alleged misrepresentation, because materiality is an element of a securities fraud claim under Rule 10b-5 *whether or not* it invokes the fraud-on-the-market theory. *Basic*, 485 U.S. at 231-32. And materiality is judged by the same objective standard in both fraud-on-the-market cases and securities fraud cases not premised on the fraud-on-the-market theory. *Id.*

Thus, answering the question of materiality does *not* determine whether the class members' claims present common or individual issues, or whether the former predominate over the latter. It determines, in one stroke, whether the claims of each member of the class survive or fail. That quality is the essence of a common question, not of an issue that must be resolved to determine *whether* common questions exist and predominate. And because the proof of an efficient market allows a common rather than individual answer to the question of reliance, common questions (including materiality) predominate in a fraud-on-the-market case, permitting certification under Rule 23(b)(3). In short, materiality is one of the common questions *to be answered* in a securities fraud class action, not a question that must be determined before

such an action may be *allowed* to proceed under Rule 23.

II. Requiring Plaintiffs to Prove Materiality at the Certification Stage Would Be Counterproductive.

Amgen's plea that the Court require plaintiffs to prove materiality at the certification stage does not rest on a fair reading of Rule 23—which, as shown above, provides no support for Amgen's position—but largely on the contention that the burdens of class litigation require the creation of an additional obstacle to certification of a class for this category of claims. Such policy arguments are unavailing in light of Rule 23's applicability to all claims unless Congress says otherwise. *See Shady Grove*, 130 S. Ct. at 1437. Congress has not done so here, and the Rule does not permit additional certification requirements to be engrafted onto particular types of claims because of perceived policy benefits.

In any event, the cure Amgen proposes is worse than the disease it posits. By requiring that materiality—including, in Amgen's view, such questions as the validity of Amgen's asserted truth-on-the-market defense—be tried to the court at the certification stage, Amgen's position would necessarily have the effect of postponing the certification determination until the parties had a full opportunity to pursue discovery on what is essentially a merits issue.

The 2003 Amendments to Rule 23, by changing the former requirement that the certification decision be made "as soon as practicable after commencement of an action" to the current provision calling for certification to occur "at an early practicable time" (Fed. R. Civ. P. 23(c)(1)), recognized the need for substan-

tial discovery in aid of the certification decision in many cases. See Fed. R. Civ. P. 23, Advisory Comm. Notes to 2003 Amendments, Subdivision (c), Paragraph (1). As the Advisory Committee explained:

> Although an evaluation of the probable outcome on the merits is not properly part of the certification decision, discovery in aid of the certification decision often includes information required to identify the nature of the issues that actually will be presented at trial. In this sense it is appropriate to conduct controlled discovery into the "merits," limited to those aspects relevant to making the certification decision on an informed basis.

Id. By significantly expanding the degree to which the certification decision would turn on the resolution of the merits of the claim, Amgen's position would concomitantly expand the merits-related discovery needed to allow resolution of the certification issue.

Moreover, it seems unlikely that Amgen's position would be limited to the issue of materiality. Amgen's expansive logic would lead to the troubling conclusion that still other merits issues, such as whether representations were false or misleading, should also be resolved at the certification stage. Each additional merits issue folded into the certification decision would carry with it additional needs for discovery and would increase the extent to which the certification hearing would replicate the trial on the merits of the class's securities fraud claims.

The unnecessary replication of the adjudication of the merits of the claim at the certification stage would increase the burden on the court and impose additional costs on plaintiffs with potentially meritorious claims. Indeed, it would prevent a class whose claims

presented triable issues of fact as to materiality and the other elements of a fraud-on-the-market claim under the summary judgment standard—that is, issues on which a reasonable jury could permissibly reach a decision either way, *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986)—from reaching a jury on a classwide basis unless the plaintiffs proved their claim to the judge's satisfaction, a considerably greater burden than avoiding summary judgment.

But Amgen's approach would also undercut the very benefits Amgen seeks to achieve for defendants. By substantially delaying the time when the certification decision could be made and greatly increasing the scope of precertification discovery, most of which would be sought from the defendants, Amgen's approach would shift costs and burdens now borne by defendants *after* certification to the precertification phase of the case. The demands of facing an *uncertified* securities fraud class action would increasingly approximate those of defending a certified class action, ratcheting up the settlement pressures that Amgen points to as the principal reason for adopting its position.

Moreover, requiring adjudication of materiality and other merits questions common to the class as part of the certification decision would greatly *increase* the stakes of that determination for defendants as well as plaintiffs. Class certification would reflect a judge's factual finding not only that the securities at issue were traded in an efficient market, but also that the defendants had made material misrepresentations on which class members trading during the class period had presumptively relied. Although the defendants would likely have the opportunity to relitigate those

issues before a jury if the case went to trial, a judge's findings that the plaintiffs had already proved most of their merits case to his satisfaction would send a clear signal that the defendants had a greatly reduced chance of prevailing on the merits at a trial. In addition, a judge's finding as a matter of fact that the plaintiff had shown a material misrepresentation would certainly rule out a later grant of summary judgment to the defendant on that issue, as it would necessarily eliminate any possibility that the defendant could carry its burden of persuading the judge that there was not even a triable issue of fact as to materiality. The heightened significance of the certification decision would accentuate the shift of the burden of defending the case from after certification to before.

At the same time, deciding materiality at the certification stage would deprive defendants of much of the benefit of a *favorable* determination on that issue. If materiality were a criterion for class certification, a judicial determination that misrepresentations were not material would bind the named plaintiff with respect to the certification determination, but not with respect to the issue of materiality insofar as it is an element of the named plaintiff's individual claim. Even where a question is decided at the certification stage, it must be decided again at trial if it is an element of a substantive claim or defense. *Wal-Mart*, 131 S. Ct. at 2552 n.6. *Cf. Lytle v. Household Mfg., Inc.*, 494 U.S. 545 (1990). Thus, a ruling on materiality at the certification stage would not stop even the named plaintiff from relitigating that issue on the merits.

More importantly, adopting Amgen's position would deprive litigants and the judicial system of the

principal benefits of class actions: the gains in efficiency, fairness, and repose that accrue when genuinely common issues are litigated together on the merits in such a manner as to yield judgments that bind plaintiffs and defendants alike. A finding of lack of materiality at the certification stage would not be binding on any class member who was not a named plaintiff, either with respect to the merits of the absent class member's securities fraud claims or with respect to whether a class could be certified in another case presenting identical claims. This Court unanimously held in *Smith v. Bayer Corp.* that "in the absence of a certification under ... Rule [23], the precondition for binding [a nonparty class member] was not met. Neither a proposed class action nor a rejected class action may bind nonparties." 131 S. Ct. 2368, 2380 (2011). As *Smith v. Bayer* makes clear, the principle that a decision not to certify a class does not bind absent class members applies equally to the merits of the absent class members' claims and to the issue of class certification itself. *See id.* at 2381 (acknowledging the point that "under our approach class counsel can repeatedly try to certify the same class").

Thus, under Amgen's approach of deciding materiality at the certification stage, a decision that a class could not be certified because a misrepresentation was not material would never estop another class member from making the same allegation of materiality in a subsequent fraud-on-the-market securities fraud case, *or from seeking to have an identical class certified to pursue that identical claim*. Moreover, each subsequent plaintiff would receive the benefit of tolling of the applicable statute of limitations during the time when the prior, unsuccessful class claims were pending. Indeed, this Court in *Smith v. Bayer* explicitly ob-

served that the rule that denials of class certification do not bind absent class members is fully consistent with the Court's decisions holding that the pendency of an uncertified class action tolls statutes of limitations for absent class members. *Id.* at 2379, n.10.[2]

As this Court recognized in *Amchem, Inc. v. Windsor*, the entire objective of Rule 23(b)(3) is "to cover cases 'in which a class action would achieve economies of time, effort, and expense, and promote ... uniformity of decision as to persons similarly situated, without sacrificing procedural fairness or bringing about other undesirable results.'" 521 U.S. at 615 (quoting Fed. R. Civ. P. 23, Advisory Comm. Notes to 1966 Amendments, Subdivision (b)(3)). In circumstances where an efficient market exists, *Basic* establishes that the claims of securities fraud plaintiffs turn together on common issues including materiality, falsity, and scienter. The considerations of fairness and judicial economy on which Rule 23 is based are best served by recognizing those common questions for what they are and allowing them to receive a common answer on the merits—whether favorable or unfavorable to the defendants.

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[2] Appellate decisions predating *Smith v. Bayer* and *Shady Grove* have indicated that later plaintiffs seeking to have class actions certified, as opposed to asserting individual claims, may not receive the full benefit of tolling. *See, e.g.*, *Yang v. Odom*, 392 F.3d 97 (3d Cir. 2004). But those decisions appear impossible to square with *Smith*'s holding that denials of certification are not binding on absent class members and with *Shady Grove*'s recognition that plaintiffs with viable individual claims are entitled to maintain class actions if they satisfy the terms of Rule 23.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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AMGEN, INC., ET AL.,
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS
AND TRUST FUNDS,
Respondent.

On Writ of Certiorari
to the United States Court of Appeals
for the Ninth Circuit

BRIEF OF *AMICUS CURIAE* PUBLIC JUSTICE, P.C. IN SUPPORT OF RESPONDENT

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INTEREST OF THE *AMICUS CURIAE*[1]

Public Justice, P.C. ("Public Justice") is a national public interest law firm dedicated to pursuing justice for the victims of corporate and government abuses. Public Justice specializes in precedent-setting and socially significant individual and class action litigation designed to advance civil rights and civil liberties, consumer and victims' rights, workers' rights, the preservation of the civil justice system and the protection of the poor and powerless. Public Justice regularly represents consumers and employees in class actions, and our experience is that the class action device often represents the only meaningful way that individuals can vindicate important legal rights. Public Justice is gravely concerned that the arguments advanced by Petitioners in this case would, if adopted, erode the only remedy available for large numbers of victims of corporate misconduct.

SUMMARY OF THE ARGUMENT

In their joint amicus brief filed on behalf of Petitioners, the Chamber of Commerce, PhRMA and BIO suggest that class action securities litigation unfairly targets the pharmaceutical industry with frivolous litigation. They claim that the resolution for

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[1] Pursuant to Sup. Ct. R. 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part and that no person other than *amici*, their members, and their counsel made a monetary contribution to its preparation or submission. The parties have consented to the filing of this brief.

which Petitioners argue is not merely practical, but indeed "safeguards the productivity of the U.S. economy," Chamber Br. 27, noting that the percentage of large health care companies "targeted in securities class actions" doubled in 2010, *id.* PhRMA pleads its case in a more self-interested way, *id.* at 2 (. ne issues in this case are especially significant to PhRMA members because many of them have borne the expense and burden of defending against securities-fraud class actions in recent years, which raise the already substantial cost and risks of developing new medicines.").

As Respondents observe, Congress has already considered and addressed these policy arguments. *See* Resp. Br. 38-41. Rather than requiring that courts answer common questions at class certification – which would undermine the very purpose of class actions – Congress has implemented procedural protections to "raise the bar" for plaintiffs asserting securities fraud actions. *Id.* at 39. Given the response by Congress, the Court should refuse to re-weigh the same policy arguments.

But there is a substantive response to these arguments that is at least as compelling. Any increased "targeting" of pharmaceutical companies in securities litigation does not reflect a problem with the securities laws or the rules of class certification, but results directly from the cancer of fraud that has spread throughout the modern pharmaceutical industry. Indeed, the pharmaceutical industry has now surpassed the defense industry as the largest

defrauder of the federal government, measured by payments made for violations of the False Claims Act.[2] The trend is accelerating: of the almost $20 billion in such payments between 1991 and 2010, three-quarters came in the last five years.[3] Promotion of drugs for uses not approved by the U.S. Food and Drug Administration ("FDA"), concealing and misrepresenting safety information, exploiting improper relationships with prescribing physicians and manipulating the reimbursement system of governmental insurers such as Medicare and Medicaid -- all to induce more and more prescriptions in higher and higher doses -- have become far too common courses of conduct. Despite billions of dollars in payments for False Claims Act ("FCA") violations, moreover, these practices continue. In Section I, Public Justice illustrates the scope of the problem by identifying representative examples of health care fraud in the last decade.

Petitioner Amgen has been a willing participant in these activities, including with respect to the drugs at issue in this litigation. Amgen extensively promoted Epogen and Aranesp in doses exceeding FDA's approved targets; manipulated the reporting of scientific studies to hide safety risks; marketed the

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[2] Press Release, Public Citizen, *Pharmaceutical Industry Is Biggest Defrauder of the Federal Government Under the False Claims Act, New Public Citizen Study Finds* (Dec. 16, 2010), http://www.citizen.org/pressroom/pressroomredirect.cfm?ID=3239.

[3] *Id.*

drugs based on improvement of "quality of life," a claim for which there has never been scientific support; supplied to physicians and clinics significantly more of the drugs than necessary, urging them to bill the excess to Medicare or Medicaid; and instructed prescribing physicians how to make their offices profit centers for the sale of these drugs, thereby inducing more and more prescriptions. The result was a period of more than two decades in which Amgen realized billions in profits from drugs for which it greatly overstated the benefits, but largely hid the risks. One year ago, Amgen finally agreed to pay $780 million to address federal criminal and civil investigations and to settle the False Claims Act charges resulting from its conduct.[4] This was merely a nod to an incidental cost of doing business in the pharmaceutical industry.

ARGUMENT

I. A MULTITUDE OF CASES ILLUSTRATE THE SYSTEMIC FRAUD IN THE PHARMACEUTICAL INDUSTRY.

The False Claims Act, 31 U.S.C. § 3729 *et seq.* ("FCA") prohibits submitting false or fraudulent claims for payment to the United States. Despite billions of dollars paid for violations of the Act, the prospect of profits far in excess of potential fines and settlements

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[4] Andrew Pollack, *Amgen to Pay $780 Million to Settle Suits on Its Sales*, N.Y. Times (Oct. 24, 2011) ("Pollack"), http://www.nytimes.com/2011/10/25/health/25amgen.html?_r=0.

has led numerous pharmaceutical companies to engage in enormous health care fraud.

1. Marketing drugs for uses beyond those approved by FDA provides a significant economic opportunity. The use of a drug for an indication approved by FDA, in accordance with the parameters of that approval, is termed "on-label" use. Once FDA approves a drug for *any* indication, however, a physician may prescribe the drug for any *other* indication or for use in a manner beyond the parameters of FDA approval. Such use of a drug is termed "off-label." While FDA regulations prohibit the promotion of drugs for off-label use, *see* 21 C.F.R. § 201.1(e)(4)(i)(a), drug companies, spearheaded by Petitioners' *amicus* the Washington Legal Foundation, have successfully asserted that a First Amendment right to disseminate truthful information about even unapproved uses and benefits of their drugs forecloses FDA's efforts to prohibit such promotion. *See, e.g., Wash. Legal Found. v. Friedman*, 13 F. Supp. 2d 51, 62 (D.D.C. 1998), *vacated as moot by Wash. Legal Found. v. Henney*, 202 F.3d 331, 337 & n.7 (D.C. Cir. 2000).[5] This has relegated FDA to attempt

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[5] Paradoxically, drug companies deny any corresponding ability to disseminate truthful information about the *safety risks* of their drugs. *E.g.*, Brief of Petitioner, *Wyeth v. Levine*, No. 06-1249, at 27 ("Wyeth was not permitted to depart from FDA's conclusion [regarding labeling of the risks and benefits of the drug] — as state law would have required—without violating the FDCA and FDA's regulations.").

damage control by enacting voluntary guidelines governing dissemination of such material.[6]

In this regulatory climate, the opportunity to maintain and expand market share by promoting off-label uses has proven irresistible, and the drug industry's circumvention of regulation in this sphere has been remarkably successful. One of every four drugs currently dispensed in this country is prescribed for uses not approved by FDA.[7] This is true even though a 2006 study found that almost three-fourths of off-label prescriptions are for uses that "lack[] evidence of clinical efficiency," while barely one-fourth "were supported by strong scientific evidence."[8]

Promotion of drugs for unapproved uses teems with the opportunity for abuse. Between 2004 and 2010, the United States resolved at least 21 significant off-label marketing cases and collected nearly $8 billion in criminal fines and civil settlements. Manufacturers

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[6] FDA, *Good Reprint Practices for the Distribution of Medical Journal Articles and Medical or Scientific Reference Publications on Unapproved New Uses of Approved Drugs and Approved or Cleared Medical Devices* (Jan. 2009), *available at* http://www.fda.gov/RegulatoryInformation/Guidances/ucm125126.htm.

[7] Kevin Loughlin & Joyce Generali, *Preface to The Guide to Off-Label Prescription Drugs: New Uses for FDA-Approved Prescription Drugs* (2006).

[8] David C. Radley et al., *Off-label Prescribing Among Office-Based Physicians*, 166 Archives Internal Med. 1021, 1023 (2006), http://archinte.jamanetwork.com/article.aspx?articleid=410250.

entered criminal guilty pleas in 15 of those cases.[9] Of those cases, 95% of the investigations were initiated by a *qui tam* complaint filed pursuant to the FCA.[10] Despite guilty pleas and billions of dollars, however, violations continue to escalate.

In May 2004, Warner-Lambert (a subsidiary of Pfizer) pled guilty and agreed to pay $430 million to resolve criminal charges and civil liabilities in connection with illegal and fraudulent promotion of unapproved uses for its drug, Neurontin.[11] In 2009, Pfizer pled guilty to off-label marketing of another drug, Bextra, and agreed to pay a $1.19 billion criminal fine plus $1 billion in civil settlements relating to the off-label promotion of Bextra and three other drugs.[12] "Pfizer promoted the sale of Bextra for several uses

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[9] *See* Antonia F. Giuliana, Esq., FCA Alert (Mar. 2, 2011), *available at* http://www.fcaalert.com/2011/03/articles/settlements-1/statistics-for-off-label-marketing-settlements-involving-prescription-drugs/.

[10] *Id.*

[11] Press Release, Department of Justice, Warner-Lambert to Pay $430 Million to Resolve Criminal & Civil Health Care Liability Relating to Off-Label Promotion (May 13, 2004), http://www.justice.gov/opa/pr/2004/May/04_civ_322.htm; hereinafter, citations to Press Releases by the Department of Justice ("DOJ") will take the form "DOJ Press Release."

[12] *See* David Evans, *Pfizer Broke the Law by Promoting Drugs for Unapproved Uses*, Bloomberg (Nov. 9, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a4yV1nYxCGoA.

and dosages that the FDA specifically declined to approve due to safety concerns," and "paid kickbacks to health care providers to induce them to prescribe these, as well as other, drugs."[13] The Assistant United States Attorney from the Neurontin prosecution summarized Pfizer's indifference, observing that, "[a]t the very same time Pfizer was in our office negotiating and resolving the allegations of criminal conduct in 2004, Pfizer was itself in its other operations violating those very same laws."[14]

Other examples of fraudulent off-label marketing abound:

- Eli Lilly and Company "agreed to plead guilty and to pay $36 million in connection with its illegal promotion of its pharmaceutical drug Evista" in December 2005. Among other allegations, Lilly had trained its sales representatives to use scientific articles to promote unapproved uses while hiding pages disclosing that "[a]ll of the authors were either employees or paid consultants of Eli Lilly at the time this article was written."[15]

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[13] DOJ Press Release, Justice Department Announces Largest Health Care Fraud Settlement in Its History (Sept. 2, 2009), http://www.justice.gov/opa/pr/2009/September/09-civ-900.html.

[14] *Id.*

[15] DOJ Press Release, Eli Lilly and Company to Pay U.S. $36 Million Relating to Off-Label Promotion (Dec. 21, 2005), http://www.justice.gov/opa/pr/2005/December/05_civ_685.html.

- InterMune agreed in October 2006 to pay more than $36.9 million to address its criminal and civil liability relating to its drug Actimmune. The company promoted the drug for an unapproved use, mischaracterizing its clinical trials as having demonstrated a benefit when none had been shown.[16]

- In May 2007, Medicis Pharmaceutical Corporation agreed to pay $9.8 million to settle claims that it had marketed its drug Loprox to children under ten, a patient population that FDA had not approved.[17]

- In September 2008, Cephalon agreed to pay $425 million to settle criminal and civil allegations relating to the off-label marketing of three of its drugs, and to plead guilty to a criminal information. FDA had approved one of the drugs, Actiq (which is manufactured as a lollipop) for use in cancer patients for whom morphine no longer was effective. But "[u]sing the mantra 'pain is pain,'" Cephalon instructed its sales representatives "to focus on physicians other than oncologists," and to promote the "highly addictive narcotic . . . for noncancer patients to use for such maladies as migraines,

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[16] DOJ Press Release, Biopharmaceutical Firm Intermune to Pay U.S. Over $36 Million for Illegal Promotion and Marketing of Drug Actimmune (Oct. 26, 2006), http://www.justice.gov/opa/pr/2006/October/06_civ_728.html.

[17] DOJ Press Release, Medicis Pharmaceutical to Pay U.S. $9.8 Million to Resolve False Claims Allegations (May 8, 2007), http://www.justice.gov/opa/pr/2007/May/07_civ_336.html.

sickle-cell pain crises, injuries, and in anticipation of changing wound dressings or radiation therapy."[18]

- In January 2009, Eli Lilly agreed to a settlement of $1.415 billion to resolve criminal and civil allegations related to the off-label marketing of its anti-psychotic drug Zyprexa. Among other actions, Lilly trained its sales representatives to promote Zyprexa to physicians caring for the elderly for such afflictions are "Alzheimer's, agitation, aggression, hostility, depression, and generalized sleep disorder," none of which were approved uses. Lilly subsequently instituted the "Viva Zyprexa" campaign to make Zyprexa an "everyday agent in primary care" even though primary care physicians do not typically treat either of the conditions for which FDA *had* approved the drug.[19]

- In March 2010, Pfizer was ordered to pay $47 million (trebled to $141 million because of the violation of the federal RICO law) for its improper promotion of Neurontin.[20] In that case, a Pfizer

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[18] DOJ Press Release, Pharmaceutical Company Cephalon to Pay $425 Million for Off-Label Drug Marketing (Sept. 29, 2008), http://www.justice.gov/civil/cpb/cases/cases/Cephalon/Cephalon%20Press%20Release.pdf.

[19] DOJ Press Release, Pharmaceutical Company Eli Lilly to Pay Record $1.415 Billion for Off-Label Drug Marketing (Jan. 15, 2009),http://www.justice.gov/usao/pae/News/Pr/2009/jan/lillyrelease.pdf.

[20] *See US Jury's Neurontin Ruling to Cost Pfizer $141 Mln*, Reuters (Mar. 25, 2010),

executive had written an e-mail calling Neurontin "the 'snake oil' of the twentieth century."[21]

- In April 2010, Astra Zeneca agreed to pay $520 million to resolve allegations that it illegally marketed Seroquel, an anti-psychotic drug, for uses not approved as safe or effective by the FDA. Approximately $302 million went to the federal government for false claims to agencies such as Medicare, with the remainder going to states for false claims submitted to state Medicaid programs.[22]

- Also in April, 2010, Ortho-McNeil Pharmaceutical & Ortho-McNeil-Janssen Pharmaceuticals, both subsidiaries of Johnson & Johnson, agreed to pay more than $81 million to resolve criminal and civil liability arising from the illegal promotion of the epilepsy drug Topamax. Ortho-McNeil Pharmaceutical, which pled guilty to criminal charges, sponsored a "Doctor-for-a-Day" program, in which it "hired outside physicians to join sales representatives in their visits to the offices of health

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http://www.reuters.com/article/2010/03/25/pfizer-neurontin-idUSN259778920100325.

[21] Jim Edwards, *Lesson From Pfizer: Don't Describe Your Product as "Snake Oil" in Internal Email* (Mar. 26, 2010), http://www.cbsnews.com/8301-505123_162-42844492/lesson-from-pfizer-dont-describe-your-product-as-snake-oil-in-internal-email/.

[22] DOJ Press Release, Pharmaceutical Giant AstraZeneca to Pay $520 Million for Off-Label Drug Marketing (Apr. 27, 2010), http://www.justice.gov/opa/pr/2010/April/10-civ-487.html.

care providers and to speak at meetings and dinners about prescribing Topamax for unapproved uses and doses."[23]

- In 2010, Allergan pled guilty and agreed to pay $600 million for marketing its drug Botox between 2000 and 2005 for such unapproved uses as "headache, pain, muscle stiffness and juvenile cerebral palsy."[24]

- In October 2010, GlaxoSmithKline pled guilty to felony and misdemeanor charges of manufacturing and distributing adulterated drugs made at its now-closed facility in Puerto Rico. The company agreed to pay a $150 million in criminal fine and forfeiture, plus $600 million to settle the civil claims. The manufacturing defects caused the drugs to fall outside the parameters of their FDA approvals.[25]

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[23] DOJ Press Release, Two Johnson & Johnson Subsidiaries to Pay Over $81 Million to Resolve Allegations of Off-Label Promotion of Topamax (Apr. 29, 2010), http://www.justice.gov/opa/pr/2010/April/10-civ-500.html.

[24] Catherine Larkin, *Allergan Will Pay Fine, Plead Guilty to Misdemeanor*, Bloomberg (Sept. 1, 2010), http://www.bloomberg.com/news/2010-09-01/allergan-will-pay-600-million-plead-guilty-to-misdemeanor-in-botox-probe.html.

[25] DOJ Press Release, GlaxoSmithKline to Plead Guilty & Pay $750 Million to Resolve Criminal and Civil Liability Regarding Manufacturing Deficiencies at Puerto Rico Plant (Oct. 26, 2010), http://www.justice.gov/opa/pr/2010/October/10-civ-1205.html.

- In December 2010, Elan agreed to pay more than $203 million to resolve criminal and civil charges under the FCA for the illegal promotion of the epilepsy drug Zonegran. Elan promoted Zonegran for "a wide variety of improper off-label uses including mood stabilization for mania and bipolar disorder, migraine headaches, chronic daily headaches, eating disorders, obesity/weight loss and seizures in children under the age of 16. Elan's off-label marketing efforts targeted non-epilepsy prescribers and the company paid illegal kickbacks to physicians in an effort to persuade them to prescribe Zonegran for these off-label uses."[26]

- In October 2011, Pfizer agreed to pay $14.5 million to resolve FCA allegations that it had marketed its drug Detrol for uses not approved by FDA.[27]

- In April 2012, a district court imposed a $321 million criminal fine on Merck for promoting an off-label use of its drug Vioxx, even after FDA had warned the company not to do so. This followed a civil settlement five months earlier, in which Merck agreed to pay more than $628 million to resolve allegations of making "inaccurate, unsupported, or

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[26] DOJ Press Release, Pharmaceutical Companies to Pay $214.5 Million to Resolve Allegations of Off-Label Promotion of Zonegran (Dec. 15, 2010), http://www.justice.gov/opa/pr/2010/December/10-civ-1444.html.

[27] DOJ Press Release, Pfizer to Pay $14.5 Million for Illegal Marketing of Drug Detrol (Oct. 21, 2011), http://www.justice.gov/opa/pr/2011/October/11-civ-1389.html.

misleading statements" regarding the safety of the drug, as well as allegations of off-label promotion.[28]

- In May, 2012, Abbot Laboratories agreed to pay $1.5 billion for its criminal and civil liability with respect to the off-label promotion of its drug Depakote, significantly to elderly patients. "In an agreed statement of facts filed in the criminal action, Abbott admit[ted] that from 1998 through 2006, the company maintained a specialized sales force trained to market Depakote in nursing homes for the control of agitation and aggression in elderly dementia patients, despite the absence of credible scientific evidence that Depakote was safe and effective for that use." Abbott also waited almost two years to notify its sales representatives who were promoting Depakote off-label to treat schizophrenia that the studies it had funded showed no benefit for that condition.[29]

- In the largest health care fraud settlement in U.S. history to date, GlaxoSmithKline pled guilty in July 2012, and agreed to pay $1 billion in criminal fines, plus another $2 billion for its civil liabilities related

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[28] DOJ Press Release, U.S. Pharmaceutical Company Merck Sharp & Dohme Sentenced in Connection with Unlawful Promotion of Vioxx (Apr. 19, 2012), http://www.justice.gov/opa/pr/2012/ April/12-civ-497.html.

[29] DOJ Press Release, *Abbott Labs to Pay $1.5 Billion to Resolve Criminal & Civil Investigations of Off-label Promotion of Depakote* (May 7, 2012), http://www.justice.gov/opa/pr/2012/ May/12-civ-585.html.

> to several of its drugs. GSK promoted off-label uses of its drugs, including by marketing unapproved uses for children, and paid kickbacks to health care professionals to induce them to prescribe its drugs. It also failed to report relevant safety data to FDA.[30]

Both the financial and public health consequences of this conduct are extremely detrimental. As an Assistant Attorney General commented with respect to Novo Nordisk's agreement to pay $25 million for illegal promotion of its hemostasis management drug, NovoSeven, in June 2011, "[t]he off-label promotion alleged here not only wasted taxpayer dollars, but also undermined the FDA's important role in ensuring that drugs are properly marketed to government agencies and members of the public."[31] Sadly, this has become a common practice.

2. The influence of pharmaceutical companies on the practice of medicine is staggering. According to a 2004 study of the 15 largest drug companies in the United States, the industry spent just under a third of its total budget for marketing on payments to

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[30] DOJ Press Release, GlaxoSmithKline to Plead Guilty and Pay $3 Billion to Resolve Fraud Allegations and Failure to Report Safety Data (July 2, 2012), http://www.justice.gov/opa/pr/2012/July/ 12-civ-842.html.

[31] DOJ Press Release, Danish Pharmaceutical Novo Nordisk to Pay $25 Million to Resolve Allegations of Off-Label Promotion of Novoseven (June 10, 2011), http://www.justice.gov/opa/pr/ 2011/June/11-civ-764.html.

physicians.[32] These payments have produced results. According to a national survey published in *The New England Journal of Medicine* in 2007, 94% of physicians had some sort of financial relationship with a pharmaceutical company.[33]

The drug industry has long understood the benefits of its financial relationships with physicians. In a landmark 1992 study, researchers at the Cleveland Clinic in Ohio tracked the prescribing habits of physicians who attended drug companies' "all-expenses-paid trips to popular . . . vacation sites to attend symposia."[34] The researchers looked at each physician's prescribing habits for two intravenous drugs (an antibiotic and a heart medication) for the 22 months prior to the trip and the 17 months afterward. Prescriptions written for the antibiotic initially increased tenfold after the trip, then leveled off to a rate that was more than three times higher than previous levels. Prescriptions for the heart medication increased to four and a half times their pre-trip levels. Research also shows that physicians who receive

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[32] Carl Elliott, *White Coat, Black Hat: Adventures on the Dark Side of Medicine* 78 n.3 (Beacon Press 2010).

[33] Eric G. Campbell et al., *A National Survey of Physician-Industry Relationships*, 356 N. Eng. J. Med. 1742, 1746 & 1746 tbl.2 (Apr. 2007).

[34] James P. Orlowski & Leon Wateska, *The Effects of Pharmaceutical Firm Enticements on Physician Prescribing Patterns: There's No Such Thing as a Free Lunch*, 102 Chest 270, 270 (1992).

payments and perks from a pharmaceutical company are more likely to ask that hospitals, practice groups, and insurers use that company's drugs.[35]

This influence leads to tangible financial benefits. In a Texas case against Janssen Pharmaceuticals for its fraudulent marketing of the drug Risperdal, the evidence showed that the state's medical algorithm favored Risperdal as a first-line drug. Tellingly, physicians involved in developing the algorithm testified that they had received thousands of dollars in payments from Janssen, including funding of trips to other states to promote the Texas system.[36] When Texas subsequently sued Janssen for Medicaid fraud based, *inter alia*, on its "improperly influencing officials and doctors to push the drug," Janssen settled for $158 million, an amount which, in the words of one commentator, "will barely blink their corporate eyeballs as they make out the check."[37] Janssen and its parent, Johnson & Johnson, subsequently paid fines or settlements of $1.2 billion in Arkansas, $327 million in South Carolina and $258 million in Louisiana for its

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[35] Ashley Wazana, *Physicians and the Pharmaceutical Industry: Is a Gift Ever Just a Gift?*, 283 JAMA 373, 376 (2000).

[36] *See State ex rel. Jones v. Janssen LP*, No. D-1-GV-04-001288, Tr. of Alexander Miller & Steven Shon (Tex. Dist. Travis Co. Jan. 11, 2012).

[37] John M. Grohol, *Johnson & Johnson Settles 3rd Risperdal Lawsuit for $158M*, PsychCentral (Jan. 25, 2012), http://psychcentral.com/blog/archives/2012/01/25/johnson-johnson-settles-3rd-risperdal-lawsuit-for-158m/.

fraudulent marketing of Risperdal.[38] It expect to settle similar claims with the Justice Department for $2.2 billion.[39]

Other cases also illustrate the industry's improper influence on the practice of medicine.

- In July 2004, Schering-Plough agreed to pay $345 million to resolve criminal and civil liabilities for its illegal marketing of Claritin. Claritin was much more expensive than Allegra, another allergy medication, but Schering paid an HMO a $1.8 million kickback to keep Claritin on its formulary. The U.S. Attorney who negotiated the guilty plea observed that "[t]his wasn't a mistake. It was a marketing strategy. The result was that programs created to provide healthcare to the poorest among us were actually paying more for drugs than those who have private health insurance."[40]

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[38] Katie Thomas, *J&J Fined $1.2 Billion in Drug Case*, N.Y. Times (Apr. 11, 2012), http://www.nytimes.com/2012/04/12/business/drug-giant-is-fined-1-2-billion-in-arkansas.html.

[39] Alexander Gaffney, *Reports: Johnson & Johnson to Pay $2.2 Billion to Settle Risperdal Marketing Probe*, Regulatory Affairs Prof'ls Soc'y (June 11, 2012), http://www.raps.org/focus-online/news/news-article-view/article/1702/reports-johnson-johnson-to-pay-22-billion-to-settle-risperdal-marketing-probe.aspx.

[40] DOJ Press Release, Schering-Plough to Pay $345 Million to Resolve Criminal and Civil Liabilities for Illegal Marketing of Claritin (July 30, 2004), http://www.justice.gov/opa/pr/2004/July/04_civ_523.htm.

- In October 2005, Serono agreed to pay $704 million to address its criminal and civil liability for promoting its drug Serotism." As part of the agreement, "Serono Labs agreed to plead guilty to offering physicians an all expense-paid trip to a medical conference in Cannes, France in return for the doctors writing up to 30 new prescriptions of Serotism, which cost $21,000 per course of treatment, for a total value of $630,000 per doctor."[41]

- Medco Health Solutions, the nation's second largest pharmacy benefit management company, agreed in October 2006 to pay $155 million to settle allegations that the company "submitted false claims to the government, solicited and accepted kickbacks from pharmaceutical manufacturers to favor their drugs, and paid kickbacks to health plans to obtain business."[42]

- Merck agreed to pay more than $650 million in February 2008 to settle allegations that it defrauded Medicaid and other government health care programs. Allegations of kickbacks figured prominently in the prosecution: "Merck had approximately fifteen different programs used by its sales representatives to induce physicians to use its

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[41] DOJ Press Release, Serono to Pay $704 Million for the Illegal Marketing of AIDS Drug (Oct. 17, 2005), http://www.justice.gov/opa/pr/2005/October/05_civ_545.html.

[42] DOJ Press Release, Medco to Pay U.S. $155 Million to Settle False Claims Act Cases (Oct. 23, 2006), http://www.justice.gov/opa/pr/2006/October/06_civ_722.html.

many products. These programs primarily consisted of excess payments to physicians that were disguised as fees paid to them for training,' 'consultation' or 'market research.'"[43]

- In March 2010, Alpharma Inc. "agreed to pay $42.5 million to resolve FCA allegations in connection with the marketing of the morphine-based drug, Kadian." Alpharma allegedly paid health care providers to induce them to prescribe Kadian and made misrepresentations about the safety and efficacy of the drug.[44]

- Forest Laboratories pled guilty in September 2010 to a criminal felony count of obstructing justice and criminal misdemeanor charges of off-label promotion and distributing misbranded drugs. Although FDA had approved certain drugs for use only in adult patients, Forest promoted them for use by children, using "illegal kickbacks." The total payment was more than $313 million.[45]

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[43] DOJ Press Release, Merck to Pay More than $650 Million to Resolve Claims of Fraudulent Price Reporting and Kickbacks (Feb. 7, 2008), http://www.justice.gov/opa/pr/2008/February/08_civ_094.html.

[44] DOJ Press Release, Alpharma to Pay $42.5 Million to Resolve False Claims Act Allegations in Connection with Promotion of Drug Kadian (Mar. 16, 2010), http://www.justice.gov/opa/pr/2010/March/10-civ-269.html.

[45] DOJ Press Release, Drug Maker Forest Pleads Guilty; to Pay More Than $313 Million to Resolve Criminal Charges and False

- In May 2011, Serono Laboratories "agreed to pay $44.3 million to resolve FCA allegations in connection with the marketing of the drug Rebif. The settlement resolves allegations that, [for eight years], Serono paid health care providers to induce them to promote or prescribe Rebif." A U.S. Attorney involved in the prosecution emphasized that "[h]ealth care decisions must be based solely upon what is best for the individual patient and not on which pharmaceutical company is paying the doctor the biggest kickback."[46]

3. The manner in which government programs such as Medicare and Medicaid reimburse health care practitioners for drugs they dispense also provides a recipe for more and more drugs, at higher and higher prices. Government healthcare programs set their reimbursement rates by the prices that drug companies report. But if a drug company actually sells the drug to a health care provider for less than the price it reported, the reimbursement for the drug itself becomes a profit center for the provider. "The difference between the resulting inflated government payments and the actual price paid by healthcare

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Claims Act Allegations (Sept. 15, 2010), http://www.justice.gov/opa/pr/2010/September/10-civ-1028.html.

[46] DOJ Press Release, Serono to Pay $44.3 Million to Resolve False Claims Act Allegations in Connection with Promotion of Drug Rebif (May 4, 2011), http://www.justice.gov/usao/md/Public-Affairs/press_releases/press08/SeronotoPay44.3MilliontoResolveFalseClaimsActAllegations.html.

providers for a drug is referred to as the 'spread.' The larger the spread on a drug, the larger the profit for the health care provider or pharmacist who gets reimbursed by the government."[47] The incentive is clear: the more prescriptions a physician writes, the more money he will make.

In December 2010, three drug companies agreed to pay a total of $421 million to settle FCA allegations that they had manipulated the spread with respect to numerous drugs. As the U.S. Attorney observed, "[s]ome pharmaceutical manufacturers have asserted that a culture within the industry gave them license to manipulate the system to suit their interests. This is not the case."[48] Again, this was not an isolated event.

- In 2001, a federal grand jury indicted TAP Pharmaceutical Products, six of its managers and a physician, charging a conspiracy to pay kickbacks to physicians, as well as other Medicaid pricing crimes. In October of that year, TAP agreed to pay $875 million to address its criminal and civil liability. The U.S. Attorney prosecuting the case explained that "[i]n all instances where the kickbacks worked to ensure the prescription of TAP's product Lupron, the Medicare Program and the elderly Americans suffering from prostate cancer paid more for their

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[47] DOJ Press Release, Pharmaceutical Manufacturers to Pay $421.2 Million to Settle False Claims Act Cases (Dec. 7, 2010), http://www.justice.gov/opa/pr/2010/December/10-civ-1398.html.

[48] *Id.*

care than if the doctor had prescribed the competitor's product."[49]

- In October 2002, Pfizer and its subsidiaries, Warner-Lambert and Parke-Davis, agreed to pay $49 million to settle allegations of violations of the FCA. Allegations include that "the defendants fraudulently avoided paying fully the rebates owed to the state and federal governments under the national drug Medicaid Rebate program for the cholesterol-lowering drug Lipitor."[50]

- In June 2003, AstraZeneca pled guilty to various health care pricing crimes and agreed to pay a total of $355 million to resolve its criminal and civil liabilities. In addition to manipulating the spread by setting prices of its drug Zoladex in excess of the actual prices it charged to providers, AstraZeneca induced over-prescription of Zoladex by liberally providing free samples (which it knew the providers could then bill to Medicare and Medicaid) and by promising "unrestricted educational grants, business assistance grants and services, travel and

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[49] DOJ Press Release, TAP Pharmaceutical Products Inc. and Seven Others Charged with Health Care Crimes; Company Agrees to Pay $875 Million to Settle Charges (Oct. 3, 2001), http://www.justice.gov/opa/pr/2001/October/513civ.htm.

[50] DOJ Press Release, Drug Giant Pfizer & Two Subsidiaries to Pay $49 Million for Defrauding Drug Medicaid Rebate Program (Oct. 28, 2002), http://www.justice.gov/opa/pr/2002/October/02_civ_622.htm.

entertainment, consulting services, and honoraria."[51]

- In September 2005, GlaxoSmithKline paid more than $150 million to settle FCA allegations that it had manipulated the spread of its drugs Zofran and Kytril. With respect to Kytril, the government alleged that "the drug company engaged in a 'double dipping' billing scheme by encouraging customers to pool leftover vials of Kytril to create an extra dose, which then would be administered to a patient and re-billed to Medicare and other federal healthcare programs."[52]

- In November 2005, King Pharmaceuticals agreed to pay more than $124 million plus interest to resolve charges that it misrepresented the prices of its drugs to Medicaid during an eight-year period.[53]
- In September 2007, Aventis Pharmaceuticals paid more than $190 million to resolve allegations that it had manipulated the spread to inflate governmental

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[51] DOJ Press Release, AstraZeneca Pharmaceuticals LP Pleads Guilty to Healthcare Crime; Company Agrees to Pay $355 Million to Settle Charges (June 20, 2003), http://www.justice.gov/opa/pr/2003/June/03_civ_371.htm.

[52] DOJ Press Release, GlaxoSmithKline Pays $150 Million to Settle Drug Pricing Fraud Case (Sept. 20, 2005), http://www.justice.gov/opa/pr/2005/September/05_civ_489.html.

[53] DOJ Press Release, King Pharmaceuticals to Pay U.S. $124 Million for Medicaid Rebate Underpayments & Overcharging for Drug Products (Nov. 1, 2005), http://www.justice.gov/opa/pr/2005/November/05_civ_581.html.

reimbursements in order to induct physicians to prescribe more of its drug, Anzemet.[54]

- Aventis Pharmaceutical Inc. agreed to pay $95.5 million in May 2009 to settle allegations that it had misreported the prices of its drugs to avoid paying Medicaid based on the actual prices it charged for its drugs. "In order to avoid triggering a new best price that would obligate it to pay millions of dollars in additional drug rebates to Medicaid, Aventis entered into 'private label' agreements with the HMO Kaiser Permanente that simply repackaged Aventis's drugs under a new label."[55]

- In October 2009, four pharmaceutical companies – Mylan Pharmaceuticals, UDL Laboratories, AstraZeneca and Ortho McNeil – agreed to pay a total of $124 million to settle claims that they had intentionally classified drugs as other drugs to significantly decrease their rebate payments to Medicaid.[56]

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[54] DOJ Press Release, Aventis Pays More than $190 Million to Settle Drug Pricing Fraud Matters (Sept. 10, 2007), http://www.justice.gov/opa/pr/2007/September/07_civ_694.html.

[55] DOJ Press Release, Aventis Pharmaceutical to Pay U.S. $95.5 Million to Settle False Claims Act Allegations (May 28, 2009), http://www.justice.gov/opa/pr/2009/May/09-civ-520.html.

[56] DOJ Press Release, Four Pharmaceutical Companies Pay $124 Million for Submission of False Claims to Medicaid (Oct. 19, 2009), http://www.justice.gov/opa/pr/2009/October/09-civ-1120.html.

- Dey Inc. agreed in December 2010 to pay $280 million to settle FCA allegations that it had "created artificially inflated spreads to market, promote and sell the drugs to existing and potential customers." The Assistant Attorney General emphasized that "[t]axpayer-funded kickback schemes like this not only cost federal health care programs millions of dollars, they threaten to undermine the integrity of the choices health care providers make for their patients."[57]

The Health and Human Services Inspector General underscored the practical effect of the continuing violations in connection with GSK's 2005 settlement: "Any pharmaceutical company that intentionally inflates the cost of prescription drugs with elaborate pricing schemes robs states and beneficiaries nationwide of millions of Medicare and Medicaid dollars. We will not tolerate any company abusing programs intended to benefit our most vulnerable citizens."[58] Despite the government's best efforts, however, health care fraud has become entrenched in the industry.

II AMGEN'S ACTIONS WITH RESPECT TO ARANESP AND EPOGEN MIRROR THE SAME

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[57] DOJ Press Release, Pharmaceutical Manufacturer to Pay $280 Million to Settle False Claims Act Case (Dec. 20, 2010), http://www.justice.gov/opa/pr/2010/December/10-civ-1464.html.

[58] *See* DOJ Press Release, *supra* note 52.

INDUSTRY-WIDE PROBLEMS IDENTIFIED ABOVE.

Amgen's actions with respect to the drugs at issue in this case reveal the same cancer that has spread throughout the industry.

1. Epogen and Aranesp are in a drug class known as erythropoiesis-stimulating agents ("ESAs"). ESAs stimulate the production of red blood cells, thereby increasing a patient's red blood cell count ("hematocrit"), and FDA initially approved both Epogen (1989) and Aranesp (2001) for treatment of anemia associated with chronic renal failure.[59] In healthy individuals, red blood cells comprise 40 percent or more of their blood. In individuals with severe anemia, however, hematocrit can dip below 25 percent, causing significant health complications.[60] Although blood transfusions address severe anemia, they can boost the hematocrit in severely anemic patients only

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[59] FDA Briefing Document, *Continuing Reassessment of the Risks of Erythropoiesis-Stimulating Agents (ESAs) Administered for the Treatment of Anemia associated with Cancer Chemotherapy for May 10, 2007 Meeting of Oncologic Drugs Advisory Committee*, FDA, at 10 ("2007 Briefing Document"), available at http://www.fda.gov/ohrms/dockets/ac/07/briefing/2007-4301b2-02-FDA.pdf.

[60] *See* Daniel W. Coyne, *Opinion: Misleading Drug Trials Amgen's Incomplete Report on an Early Major Trial of Epoetin Misled the Medical Community About the Anemia Drug's Risks and Benefits—and Helped Make Amgen Rich*, The Scientist (May 14, 2012) ("Coyne, Scientist"), http://the-scientist.com/2012/05/14/opinion-misleading-drug-trials/.

to 30 percent or so, far short of "normal." Thus, the development of ESAs, offering the prospect of increasing hematocrit without the significant risks posed by blood transfusions, sparked great optimism. It also sparked a great marketing opportunity.

When FDA first approved Epogen, it approved a hematocrit target range of 30%-33%, close to the level that could be reached in a transfusion.[61] In 1995, at Amgen's suggestion, FDA raised the upper end of the target to 36%.[62] This change had "huge financial implications" for Amgen, as achieving this three percent increase required "about 40 percent more of the drug, a jump that would push the amount consumed from $7,000 to $10,000 annually."[63] The upper end of the FDA-approved target range would remain at 36% until 2011, when FDA directed that

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[61] Food & Drug Admin., Drugs@FDA: FDA Approved Drug Products at cols. 1, 6 (PROCRIT/EPOGEN – Label Information (Apr. 1, 1993)) ("1993 Label"), *available at* http://www.accessdata.fda.gov/drugsatfda_docs/label/pre96/103234s1015_LBL.pdf.

[62] Food & Drug Admin., Drugs@FDA: FDA Approved Drug Products at 2 (EPOGEN – Label Information (July 26, 1999)) ("1999 Label"), *available at* http://www.accessdata.fda.gov/drugsatfda_docs/label/2000/epoamg072699lb.pdf.

[63] Peter Whoriskey, *Anemia Drugs Made Billions, But at What Cost?*, Wash. Post, July 19, 2012 ("Whoriskey"), *available at* http://www.washingtonpost.com/business/economy/anemia-drug-made-billions-but-at-what-cost/2012/07/19/gJQAX5yqwW_story.html.

"[u]sing ESAs to target a hemoglobin level of greater than [33%][64] increases the risk of serious adverse cardiovascular reactions and has not been shown to provide additional benefits."[65]

Even the 16-year reign of a dangerously inflated hematocrit target did not satisfy Amgen. Every incremental increase in the hematocrit target meant a corresponding increase in profits, and there was still a gap between the approved upper end of 36% and a "normal" hematocrit, several points higher. Amgen sought to close this gap by promoting the ability of ESAs to improve general "quality of life." While earlier labels mentioned "quality of life,"[66] Amgen greatly expanded this alleged benefit in subsequent labels, touting the results of its clinical trials in glowing terms: "Once the target hematocrit (32% to 38%) was

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[64] The actual text defines the target as "11 g/dL." "Hematocrit [is] calculated by multiplying the measured hemoglobin (Hgb) level by three." *See* Daniel W. Coyne, *The Health-Related Quality of Life was Not Improved by Targeting Higher Hemoglobin in the Normal Hematocrit Trial*, 82 Kidney Int'l 235, 235 (2012) ("Coyne"),http://www.nature.com/ki/journal/v82/n2/full/ki201276a.html.].

[65] Food & Drug Admin., Drugs@FDA: FDA Approved Drug Products at 1 (EPOGEN – Highlights of Prescribing Information (June 24, 2011)) ("2011 Label"), *available at* http://www.accessdata.fda.gov/drugsatfda_docs/label/2011/103234Orig1s5166_103234Orig1s5266lbl.pdf.

[66] *E.g.*, 1993 Label, col. 7 ("As the hematocrit increases and patients experience an improved sense of well-being and quality of life, ...").

achieved, statistically significant improvements were demonstrated for most quality of life parameters measured, including energy and activity level, functional ability, sleep and eating behavior, health status, satisfaction with health, sex life, well-being, psychological effect, life satisfaction, and happiness."[67] The idea that "higher doses could make patients feel better" became "[t]he key to their marketing claim," forming the "basis of television and print advertising campaigns, pitched to people with potentially fatal illnesses"[68]

Amgen also marketed the idea to physicians and hospitals that hematocrit levels closer to "normal" equated to a better quality of life.[69] "'They'd bring lunch in, or they'd have presentations at conferences, and they'd always have the same message: A little was good, more is better,' said Steven Bander, formerly chief medical officer with Gambro, one of the nation's largest dialysis chains. 'They would quote all these studies about quality of life. They never talked about the negative data.'"[70] The campaign was wildly successful. In the years following FDA's initial approvals, Amgen's ESAs became blockbuster drugs. "Very quickly, the market included nearly all dialysis patients, not just the roughly 16 percent who required

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[67] 1999 Label at 5.

[68] Whoriskey.

[69] Whoriskey.

[70] Whoriskey.

blood transfusions. The size of average doses would more than triple. And during the next five years, the FDA would approve it to treat anemia in patients with cancer and AIDS, as well as those getting hip and knee surgery."[71]

To convince physicians to keep increasing dosages, it was important to maintain governmental reimbursement of the higher doses. Lobbying became critical.[72] In response to the Health Care Financing Administration's ("HCFA") announced policy to limit Medicare reimbursement to a hematocrit level consistent with the FDA-approved target range, there was a Congressional hearing in March 1998. At that hearing, Congressional members castigated the HCFA Administrator for the new policy, asserting that reimbursement in excess of the upper limit of the FDA-approved target range, and up to 37.5 percent, was

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[71] Whoriskey.

[72] According to the Center for Responsive Politics, in 1998, the pharmaceutical/health products industry spent almost $70 million on lobbying, with $2.36 million coming from Amgen. OpenSecrets.org, Lobbying: Pharmaceuticals/Health Products – Industry Profile, 1998, *at* http://www.opensecrets.org/lobby/indusclient.php?id=H04&year=1998 (last visited Sept. 25, 2012). By 2011, its lobbying expenditures exceeded $240 million– more than any other industry – with Amgen contributing $10 million of that total. *Id.* at http://www.opensecrets.org/lobby/indusclient.php?id=H04&year=2011. *See also* Whoriskey.

necessary.[73] The increase "could have raised by 20 percent the amount of Epogen that doctors could freely prescribe in an average patient, adding a cost of $2,000 or more."[74] Faced with such hostility from Congress, the regulators ultimately backed off the proposed limitation on reimbursement and agreed to the higher limits, effectively sanctioning a use of Amgen's ESAs that FDA had not approved. "On the day the agency raised the maximum level, Amgen shares spiked 6 percent."[75]

As the Washington Post observed, "[t]he doses kept rising. By 2006, about half of all dialysis patients were getting so much of the drugs that their hematocrits were rising beyond the FDA-recommended ceiling of 36 percent. More than 80 percent were getting more than the level now deemed advisable."[76] The profits transformed Amgen from a small firm into a Fortune 500 company, with "[a]s much as a third of [those

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[73] *An Act Making Appropriations for the Departments of Labor, Health and Human Services, and Education, and Related Agencies, for the Fiscal Year Ending September 30, 1999, and for Other Purposes: Hearings on H.R. 4274 / S. 2440 Before a Subcomm. of the Committee on Appropriations, United States Senate*, 105th Cong., 2nd Sess. at 69-70 (Mar. 5, 1998), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-105shrg46105/html/CHRG-105shrg46105.htm.

[74] Whoriskey.

[75] Whoriskey.

[76] Whoriskey.

profits] coming from reimbursements funded by U.S. taxpayers."[77]

2. In the mid-1990s, Amgen funded the Normal Hematocrit Trial ("NHT"), the largest trial of ESAs ever done, in an attempt to justify using ESAs to boost hematocrit levels to "normal" levels. Approximately half of the 1,265 participants were given doses to raise hematocrit levels to around 30 percent, the level that could be obtained in a blood transfusion. The others were given doses to raise hematocrit levels to 42, percent, close to the level in a normal, healthy person.[78] The hypothesis was that "higher [hematocrit levels] would reduce mortality, and improve survival and quality of life."[79] In May 1996, however, the study was terminated after 29 months because patients in the "normal level" group were dying and suffering heart attacks more frequently than the other group. "These results were not a complete surprise to [Amgen:] a rationale for the trial was an 'increased risk of mortality [as] the potential adverse effect[] of full correction of anemia in dialysis patients'."[80] In its 1996 clinical trial report, Amgen noted that patients in the 42 percent group had experienced "significantly more 'other thrombotic events'" than patients in the 30

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[77] Whoriskey.

[78] *See* Coyne Scientist.

[79] Coyne at 235.

[80] Coyne at 237.

percent group, but that "[t]here were no statistically significant changes in quality-of-life scores between groups or over time."[81] These results presented "the first major evidence of safety problems with the use of ESAs."[82]

When the results were presented to the public, however, the interpretation of the data had changed. *The New England Journal of Medicine* published the results of the NHT in 1998.[83] Four of the authors were Amgen employees who undoubtedly had access to Amgen's clinical trial report,[84] yet the published article did not contain the unadjusted statistical results. Instead, the data were adjusted to present the risk of "other thrombotic events" between the two groups as "insignificantly different." "Therefore the trial results were reported as showing only a trend toward—and

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[81] Coyne at 237. *See also* Coyne, Scientist, ("The results I found in the Amgen report, filed with the FDA in 1996, showed that *bigger epoetin doses to target higher hematocrit did not improve* the physical function quality of life component at all, and had significantly increased the risk of death, heart attack, other thrombotic events, and hospitalizations.").

[82] Coyne at 239.

[83] Anatole Besarab et al., *The Effects of Normal as Compared with Low Hematocrit Values in Patients with Cardiac Disease Who Are Receiving Hemodialysis and Epoetin*, 339 New. Eng. J. Med. 584 (1998).

[84] Coyne at 240. Although two of the other authors were consultants to Amgen, the extent to which the four non-Amgen employee authors had access is unknown. *Id.*

not solid evidence for—increased harm."[85] With respect to quality of life, the published report provided that "an increase in the hematocrit from 30 percent to 42 percent was associated with a clinically meaningful increase of 7.2 points in the score on the physical-function scale."[86] Although the published article did discourage targeting hematocrit to "normal" levels, it failed to convey the great risk in increasing the hematocrit level significantly in excess of the "transfusion" level.[87]

The perception that there was no significant risk, combined with "quality of life" message, drove clinical practice. Understatement of the risks posed by ESAs continued for nine years after the 1998 publication, and three years after the May 2004 meeting of FDA's Oncologic Drugs Advisory Committee ("ODAC"), the lead-up to which defines the beginning of the class period in this case. In the briefing document prepared for the May 2007 meeting of that committee, however, FDA finally recognized what Amgen had known *for 11 years*: "as demonstrated in the 'Normal Hematocrit' and CHOIR studies, the incidence of serious thrombotic events are increased with treatment strategies intended to maintain hemoglobin levels above [36 percent]," an increased risk that "ha[d] been consistently observed across multiple patient

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[85] Coyne, Scientist.

[86] Coyne at 237.

[87] *See* Coyne, Scientist.

populations."[88] Significantly, FDA also observed that after years of study, the data were still inconclusive about the safety risks posed by ESAs when used *on-label* to treat cancer patients: "[t]here are insufficient data to characterize the effects of ESAs on survival or on tumor promotion when ESAs are administered in accordance with recommended dosing in product labeling.[89]

Later in 2007, FDA instructed that ESA labels contain a boxed warning providing, *inter alia*, that "[p]atients experienced greater risks for death and serious cardiovascular events when administered [ESAs] to target higher versus lower hemoglobin levels . . . in two clinical studies."[90] A boxed warning is the strongest warning FDA regulations allow, short of contraindicating the use altogether. *See* 21 C.F.R. § 201.80(e). With respect to cancer patients, the boxed warning cautions that ESAs "shortened overall survival and/or increased the risk of tumor progression

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[88] 2007 Briefing Document at 9.

[89] *Id.* at 52. In the May 2004 ODAC meeting, Amgen had identified additional studies that might "further investigate the risk of ESAs." *Id.* at 19. At the May 2007 meeting three years later, FDA had received primary data from only three of the 16 studies identified. These three had "design limitations" that limited additional clarification of risks. *Id.* at 21.

[90] Food & Drug Admin., Drugs@FDA: FDA Approved Drug Products at 1 (EPOGEN/PROCRIT – Label Information (Dec. 17, 2007)) ("2007 Label"), *available at* http://www.accessdata.fda.gov/drugsatfda_docs/label/2007/103234s5163lbl.pdf

or recurrence . . . ."[91] The December 2007 label also eliminated the "quality of life" claims, emphasizing that Epogen "has not been demonstrated in controlled clinical trials to improve symptoms of anemia, quality of life, fatigue, or patient well-being."[92]

In 2011, FDA finally eliminated the 36 percent hematocrit target, acknowledging that "[n]o trial has identified a hemoglobin level, ESA dose, or dosing strategy that does not increase the[] risks" of death and "serious adverse cardiovascular reactions."[93] The current boxed warning instructs physicians to "[u]se the lowest Epogen dose sufficient to reduce the need for red blood cell (RBC) transfusions."[94] The current label also reports the NHT's "hazard ratio and confidence intervals for death and heart attack and all-cause death as significantly higher in the higher hematocrit arm,"[95] finally acknowledging the risks set forth in Amgen's 1996 clinical trial report, but hidden in the 1998 publication of its results.[96]

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[91] 2007 Label at 1.

[92] *Id.* at 4, 8.

[93] 2011 Label at 1.

[94] *Id.*

[95] Coyne, Scientist.

[96] *See* Coyne at 236.

The eventual disclosure does not rectify the intervening years. As Dr. Daniel Coyne, a professor at Washington University School of Medicine and a former paid speaker for Amgen who became a critic after the dangers posed by ESAs surfaced, summarized:

> [T]he effect was to force experts to say targeting hematocrit to about 42 percent using higher epoetin doses improved quality of life and reduced transfusions, and prevented them from saying such management significantly increased deaths, cardiac events, thrombotic events, and hospitalizations. Amgen controlled the debate, and by 2012 had made $37 billion from epoetin sales in the United States alone.[97]

3. While Amgen worked the congressional, regulatory and scientific fronts, it also took direct measures with prescribing physicians. In contrast to prescription pills that may be taken at home, ESAs must be injected in a clinical setting. As explained in section I.3, this situation allowed Amgen to exploit the "spread" between the amount paid by the provider and the amount reimbursed by insurers. The spread between the amount that health care providers charge and the amount reimbursed to them by the governmental insurers "led the Office of the Inspector General to issue at least seven reports recommending either that the reimbursement price be reduced or the incentives changed. The Government Accountability

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[97] Coyne, Scientist.

Office and the Medicare Payment Advisory Commission made similar recommendations."[98] The measures did not pass, and Amgen's profits remained robust. With respect to Amgen's ESAs, "[t]he markup that doctors, clinics and hospitals received on the drugs given to Medicare patients reached as high as 30 percent, according to the Medicare Payment Advisory Commission . . . ."[99] Even "[a]s late as 2009, dialysis clinics were getting a markup of 9 to 17 percent on the drugs, according to an inspector general's audit."[100]

In addition to the spread, Amgen induced even more ESA prescriptions by supplying physicians and clinics with much more of the drug than necessary to treat patients. Federal regulations allow vials of injectable drugs to contain enough excess to insure that the physician will be able to withdraw a full dose, but caution that "[v]ariations from stated quantity of contents shall not be unreasonably large." 21 C.F.R. § 201.51(g). With respect to its ESAs, however, Amgen has admitted that the "overfill" of Aranesp was almost double the recommended amount between 2001 and 2008.[101] Combining the spread in prices and the overfill in vials, Amgen was able to make the provision of its ESAs a spectacular profit center for health care

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[98] Whoriskey.

[99] Whoriskey.

[100] Whoriskey.

[101] *New York v. Amgen, Inc.*, 652 F.3d 103, 107 (1st Cir. 2011), *cert. dismissed*, 132 S.Ct. 993 (2011).

providers. This of course induced even more prescriptions.

According to a former Amgen pharmacist, Amgen actually provided spread sheets to physicians to illustrate how they could profit by billing the overfill amount to Medicaid or Medicare.[102] The pharmacist eventually filed a *qui tam* action under the FCA on behalf of herself, the United States, 17 individual states and the District of Columbia.[103] At their depositions in that litigation, five former Amgen executives refused to answer questions about the spread sheets, invoking their Fifth Amendment rights.[104] In October 2011, Amgen agreed to settle pending litigation involving its sales and marketing practices with respect to Epogen and Aranesp, and to address pending criminal and civil investigations, for $780 million.[105]

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[102] *See* 652 F.3d at 105. *See also* Jim Edwards, *5 Amgen Execs Plead the Fifth on Alleged Kickbacks Described in Spreadsheet*, CBS Money Watch, Mar. 2, 2011 ("*5 Amgen Execs*"), http://www.cbsnews.com/8301-505123_162-42847582/5-amgen-execs-p.

[103] 652 F.3d at 106.

[104] *5 Amgen Execs, supra.*

[105] News Release Detail, Amgen, *Amgen's Third Quarter 2011 Revenue and Adjusted Earnings Per Share (EPS) Each Increased 3 Percent to $3.9 Billion and $1.40*, Oct. 24, 2011, http://www.amgen.com/media/media_pr_detail.jsp?releaseID=1620695. *See also* Pollack, *supra.*

As discussed in part I, conduct resulting in payments of this sort has spread throughout the pharmaceutical industry. Despite the size of the payment, moreover, it made no discernible dent in the profits that Amgen realized with respect to Epogen and Aranesp. As the Washington Post summarized:

> The trouble, as a growing body of research has shown, is that for about two decades, the benefits of the drug — including "life satisfaction and happiness" according to the FDA-approved label — were wildly overstated, and potentially lethal side effects, such as cancer and strokes, were overlooked.
>
> Last year, Medicare researchers issued an 84-page study declaring that among most kidney patients, the original and largest market for the drugs, there was no solid evidence that they made people feel better, improved their survival or had any "clinical benefit" besides elevating a statistic for red blood cell count.
>
> It was a remarkable finding of futility: While drugmakers had seen billions in profits for more than 22 years, and much of it from taxpayers, millions of patients had been subjected to dangerous doses that might have had little advantage.[106]

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[106] Whoriskey. *See also* Kathleen Sharp, *Blood Feud: The Man Who Blew the Whistle on One of the Deadliest Prescription Drugs Ever* (Penguin Books 2011).

CONCLUSION

The judgment of the court of appeals should be affirmed.

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v.
CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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STATEMENT OF INTEREST

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers.[1] SIFMA's mission is to support a strong financial industry while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA has offices in New York and Washington, D.C. and is the United States regional member of the Global Financial Markets Association. SIFMA regularly files *amicus curiae* briefs in cases that raise matters of vital concern to participants in the securities industry.

SIFMA has appeared before this Court as amicus curiae in many cases involving issues arising under the federal securities laws, most recently in *Credit Suisse Securities (USA) LLC v. Simmonds*, 132 S. Ct. 1414 (2012) (considering tolling under Section 16(b) of the Securities Exchange Act of 1934); *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011) (holding that plaintiffs need not prove loss causation to obtain class certification under the fraud-on-the-market theory of reliance); *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011)

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus* certifies that no counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus* made such a monetary contribution. Letters from the parties consenting to the filing of all *amicus* briefs have been filed with the Clerk of the Court.

(involving pleading standard for materiality in private securities fraud claim), *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869 (2010) (extraterritorial application of anti-fraud provisions of federal securities laws), *Merck & Co. v. Reynolds*, 130 S. Ct. 1784 (2010) (statute of limitations for bringing private securities fraud claim), and *Jones v. Harris Associates L.P.*, 130 S. Ct. 1418 (2010) (breach of fiduciary duty under the Investment Company Act of 1940).

This case involves important issues regarding liability under the federal securities laws for misrepresentations in connection with public market transactions and the appropriate standards governing the adjudication of private securities claims under class action procedure. These issues are directly relevant to SIFMA's mission of promoting fair and efficient markets and a strong financial services industry. Resolution of these issues could have a significant effect on SIFMA's members.

SUMMARY OF ARGUMENT

Class certification requires that the class proponent demonstrate strict compliance with Rule 23 of the Federal Rules of Civil Procedure ("Rule 23"). The overwhelming majority of plaintiffs seeking class status under Rule 23(b)(3) in federal securities actions attempt to invoke the rebuttable presumption of reliance derived from the fraud-on-the-market theory. First adopted by this Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the Court has articulated four prerequisites that must be established to invoke the fraud-on-the-market

presumption: (i) that the defendant made public misrepresentations; (ii) that the misrepresentations were material; (iii) that the securities traded on an efficient market; and (iv) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed. *See id.* at 248 n.27. This case concerns the second of these prerequisites – materiality.

Under the fraud-on-the-market doctrine, immaterial statements do not impact the market price of a security and, therefore, investors do not indirectly rely upon those immaterial statements through reliance on the market price. Given the Court's strong direction to apply a rigorous analysis for determining Rule 23 compliance, the clear language of *Basic*, and the substantial *in terrorem* effects of improvidently certifying a class, SIFMA respectfully submits that the Court should require a plaintiff to establish materiality at the class certification stage or, at a minimum, permit a defendant the opportunity to rebut the presumption of reliance.

The requirement that a plaintiff establish materiality at class certification is not unduly burdensome. There are numerous practicable ways to demonstrate materiality. Although the Court has held that materiality is not suitable to a bright-line rule determination, materiality may be established through at least two practical and regularly used methods. A plaintiff may analyze the total mix of information available to market participants through review of publicly available information, including issuer disclosures, press reports, and/or reports of industry analysts. Alternatively, or in conjunction

with a review of the total mix of information, a plaintiff may submit evidence of an appropriate event study regarding the impact of an alleged misrepresentation on the market price of the security.

Moreover, there are compelling policy reasons to require the establishment of materiality at class certification. This Court and lower federal courts have acknowledged the "*in terrorem*" effects that certifying a class has on a defendant with supposed "deep pockets." *See, e.g., Coopers & Lybrand v. Livesay*, 437 U.S. 463, 476 (1978). Such effects are particularly pronounced in securities cases, where amounts in controversy can be very large. A rigorous analysis of materiality at class certification allows district courts to efficiently and fairly manage cases that are not suitable for class treatment, which will ameliorate the problem of *in terrorem* settlements in the securities context.

Regardless of the method of proof used by a plaintiff, a defendant should be permitted the opportunity to rebut the materiality of alleged misstatements with evidence supported by an analysis of the total mix of information or an event study. Without consideration of such evidence a district court cannot establish a proper class period in a securities case.

Allowing a class to be certified notwithstanding the availability of dispositive evidence refuting a claim of materiality, would unnecessarily increase the costs of defending meritless litigation and exacerbate the problem of *in terrorem* settlements of securities cases.

ARGUMENT

I. SUMMARY OF THE FRAUD-ON-THE-MARKET THEORY

A. Class Certification Requirements

The Court has long recognized that the class action is "an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only." *Califano v. Yamasaki*, 442 U.S. 682, 700-702 (1979). To permit a class action to proceed, a court must determine that the class representative "possess[es] the same interest and suffer[s] the same injury . . ." as the putative class members. *E. Tex. Motor Freight Sys., Inc. v. Rodriguez*, 431 U.S. 395, 403 (1977) (internal quotations omitted).

The burden is on the class proponent to demonstrate that all of the requirements are met under Rule 23. *See Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2548 (2011).[2] Rule 23 is not a pleading standard; rather, it requires the party seeking class certification to *prove* compliance with the rule. *Id.* at 2550. A class will only be certified if the trial court determines, after a "rigorous analysis," that all Rule 23 requirements are met. *Id.* Therefore, "'it may be necessary for the court to probe behind the pleadings before coming to rest on the

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[2] To properly certify a class, the proponent must meet all the requirements of Rule 23(a) – numerosity, commonality, typicality, and adequacy of representation – as well as one of the requirements of Rule 23(b). *See Dukes*, 131 S. Ct. at 2548.

certification question[.]'" *Id.* at 2551 (quoting *Gen. Tel. Co. of the Sw. v. Falcon*, 457 U.S. 147, 160 (1982)).[3]

B. Class Certification Requirements in Putative Securities Class Actions

In *Basic*, the Court addressed whether plaintiffs seeking class certification for claims brought under Rule 10(b) of the Securities Exchange Act of 1934 can make a class-wide showing of reliance. *Basic*, 485 U.S. at 242 ("Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action."). Recognizing difficulties in establishing individual reliance, the Court adopted a presumption allowing a plaintiff to demonstrate indirect reliance through the "fraud-on-the-market" theory. *Basic*, 485 U.S. at 247. The fraud-on-the-market presumption holds that "the market price of shares traded on well-developed markets reflects all publicly available information,

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[3] The vast majority of securities class action proponents seek certification under Rule 23(b)(3), which requires that "the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fairly and efficiently adjudicating of the controversy." Fed. R. Civ. P. 23(b)(3) (emphasis added). This Court has held that the inquiry into whether common questions predominate over individual claims is more demanding than determining the commonality prerequisite in Rule 23(a)(2). In *Dukes*, the majority opinion makes the distinction that Rule 23(b)(3) concerns whether common questions *predominate* over individual claims, whereas a Rule 23(a)(2) determination is satisfied if there is even a *single* common question. 131 S. Ct. at 2556.

and, hence, any material misrepresentations." *Id.* at 246.

In a putative securities class action involving allegations of misrepresentations, a court's rigorous analysis often turns upon the element of reliance. By extension, this usually means a focus on the fraud-on-the-market presumption. Although *Basic* did not establish a strict test to invoke the presumption of reliance, it did recognize a set of threshold requirements: (i) that the defendant made public misrepresentations; (ii) that the misrepresentations were material; (iii) that the securities traded on an efficient market; and (iv) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed. *See id.* at 248 n.27; *see also Halliburton*, 131 S. Ct. at 2185 ("It is undisputed that securities fraud plaintiffs must prove certain things in order to invoke *Basic's* rebuttable presumption of reliance.").

Since *Basic*, a circuit split has emerged regarding whether for class certification purposes materiality is an essential element to the fraud-on-the-market presumption, which is more fully discussed in Petitioners' merits brief. *Basic*, however, set the guidepost for how lower courts should interpret the fraud-on-the-market doctrine: "An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public *material misrepresentations*, therefore, may be presumed." *Basic*, 485 U.S. at 247 (emphasis added); *see also Halliburton*, 131 S. Ct. at 2185 (same). To invoke the

fraud-on-the-market presumption, then, the alleged public misstatement must be material in order to distort the market price.

II. POLICY PROBLEMS WITH CLASS CERTIFICATION BASED SOLELY ON ALLEGATIONS OF MATERIALITY

Requiring only *allegations* of materiality at class certification would substantially hinder a defendant's ability to dispute non-meritorious claims before being subjected to overwhelming settlement pressure. This Court and lower federal courts have acknowledged the "*in terrorem*" effects of certifying a class on a defendant with supposed "deep pockets." *See, e.g.*, *Coopers & Lybrand*, 437 U.S. at 476 ("Certification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense.").[4]

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[4] *See also AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1752 (2011) (recognizing the *in terrorem* effects of class actions); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 546 (2007) (same); *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 347 (2005) (same); *Regents of the Univ. of Cal. V. Credit Suisse First Bos. (USA), Inc.*, 482 F.3d 372, 379 (5th Cir. 2007) (certification is often "the backbreaking decision that places insurmountable pressure on a defendant to settle, even where the defendant has a good chance of succeeding on the merits"); *Kohen v. Pac. Inv. Mgmt. Co. LLC & PIMCO Funds*, 571 F.3d 672, 677-78 (7th Cir. 2009) (noting *in terrorem* effects on securities class action defendant); *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1092 (9th Cir. 2002) (noting that lengthening the class period to 63 weeks permitted plaintiffs to "sweep as many stock sales into their [damages] totals as possible . . ."), *overruled on other grounds by S. Ferry LP v. Killinger*, 542 F.3d 776, 784 (9th Cir. 2008); *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 978 (9th Cir. 1999)

A rigorous analysis of materiality – an antecedent of the judicially created fraud-on-the-market doctrine – at class certification allows district courts to efficiently and fairly manage cases that are not suitable for class treatment. It also ameliorates the problem of *in terrorem* settlements prevalent in the securities context.

A. Improvident Class Certification in Securities Cases Imposes Significant Costs on SIFMA Members and All Participants in the Public Securities Markets

As this Court and the circuit courts have held, a defendant in a class action can face the prospect of financial ruin in the face of a certified class of plaintiffs who may not have legally meritorious claims. The benefits of class-wide relief must be balanced against the enormity of pressure a defendant encounters to settle class claims. *See In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1297-99 (7th Cir. 1995) (discussion by Judge Posner of *in terrorem* effects of class actions in mass torts). These "*in terrorem*" effects are particularly prevalent in securities class action lawsuits. *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d at 978 (examining the history of the Private Securities Litigation

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(noting that Congress enacted the PSLRA in part to prevent abusive securities fraud class actions designed "'to impose costs so burdensome that it [was] often economical for the victimized party to settle'" (alteration in original) (quoting H.R. Rep. No. 104-369, at 41 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 730)).

Reform Act of 1995 ("PSLRA") and the reasons for enacting heightened pleading requirements); *see also Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740 (1975) (noting securities class actions have a settlement value to plaintiffs out of proportion to success on the merits). In *Regents of the Univ. of Cal.*, for example, the Fifth Circuit closely analyzed the district court's certification of a class that alleged damages of nearly $40 billion related to the collapse of Enron and reversed and remanded the case. 482 F.3d at 379, 394. The court noted that class certification is often the "backbreaking decision that places insurmountable pressure on a defendant to settle[.]" *Id.* at 379. The court in that case found that plaintiff failed to properly invoke the rebuttable presumption of reliance. *Id.* at 382-83.

B. The "*In Terrorem*" Impact of Class Certification Nearly Always Leads to Settlement

Class certification increases the likelihood of *in terrorem* settlements.[5] Since the enactment of the PSLRA, only 29 securities class action cases have been adjudicated after a jury trial as compared to over 3,800 filings.[6] Indeed, less than one-half of one

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[5] Thomas E. Willging & Shannon R. Weathman, *An Empirical Examination of Attorneys' Choice of Forum in Class Action Litigation*, Federal Judicial Center, at 50 (2005) (in one study, the *in terrorem* effects led to nearly 90% of all *certified class actions* in the study sample to settlement).

[6] Dr. Jordan Milev, Dr. John Montgomery, Robert Patton and Svetlana Starykh, *Recent Trends In Securities Class Action Litigation: 2011 Year-End Review*, NERA Economic Consulting, Dec. 21, 2011, at 12 (statistics are through December 21, 2011).

percent of all securities class actions proceed to trial on the merits.[7] In 2011, only one case, *In re Homestore.com, Inc.*, went to trial, and only against one of many defendants where all other defendants had previously settled.[8] Despite so few securities cases reaching trial, the mean settlement for securities actions was $31 million in 2011.[9]

Faced with staggering potential losses, securities class action defendants settle even non-meritorious claims rather than risk financial disaster. *See Eisen v. Carlisle & Jacquelin*, 479 F.2d 1005, 1019 (2d Cir. 1973), *vacated*, 417 U.S. 156 (1974) (noting that defendants in large class actions settle in the face of large damages "as the alternative to complete ruin and disaster, irrespective of the merits of the claim").

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[7] *See id.*

[8] *Id.* at p. 14.

[9] *Id.* at p. 17.

III. IT IS REASONABLE, PRACTICABLE, AND NOT UNDULY BURDENSOME TO REQUIRE A PLAINTIFF TO ESTABLISH MATERIALITY AT CLASS CERTIFICATION

A. Materiality Is Necessary To Determine Predominance Under Rule 23 And To Define the Class Period Properly

Rule 23(b)(3) requires that common questions of law or fact predominate over questions subject to individual determination. *Basic* recognized a rebuttable presumption permitting a plaintiff to indirectly rely on integrity in the market price, incorporating all public material information in an efficient market. *See Basic*, 485 U.S. at 242. First adopted by this Court in *Basic*, and then most recently addressed in *Halliburton*, the fraud-on-the-market hypothesis is founded on the premise that in an "open and developed securities market, the price of a company's stock is determined by the *available material information* regarding the company and its business . . . ." *Basic*, 485 U.S. at 242 (emphasis added). The Court has therefore made clear that the necessary antecedents of the fraud-on-the-market theory include: (1) materiality of the alleged misstatement and (2) an efficient market. *See id.* at 242 (internal quotations omitted); *see also Halliburton*, 131 S. Ct. at 2186 ("investor presumptively relies on a misrepresentation so long as it was reflected in the market price").

A statement is "material" if there is a substantial likelihood that an accurate disclosure would have

been viewed by the reasonable investor as having significantly altered the total mix of information made available. *See Matrixx*, 131 S. Ct. at 1318.

Proof of materiality is also necessary in many cases to establish a proper class period. *See, e.g., In re Federal Nat'l Mortg. Ass'n Secs., Derivatives, & "ERISA" Litig.*, 247 F.R.D. 32, 38 (D.D.C. 2008) ("whether the fraud-on-the-market presumption applies as a matter of law is essential for determining the duration of the class period"). In considering what period of time a misrepresentation defrauded the market, courts must consider whether and when the material facts (the truth on the market) emerged. *See Basic* 485 U.S. at 248 n.27 (requirements for the invocation of the fraud-on-the-market theory include "that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed"). Absent proof that a material misstatement entered the market and then the truth was revealed, a court simply cannot determine (1) the proper class period or (2) the typicality of class members' claims as required under Rule 23(a)(3).[10]

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[10] *See, e.g., Maiman v. Talbott*, No. SACV 09-00012 AG (AN), 2011 U.S. Dist. LEXIS 98243, at *20 (C.D. Cal. Aug. 29, 2011) ("Because it would be impossible for the Court to determine whether Plaintiffs satisfy Rule 23(a)(3) without examining the parties' arguments concerning the appropriate end date of the class period, the court turns to those arguments now.").

B. Materiality May Be Determined Through an Analysis of How a Reasonable Investor Would Have Viewed a Misrepresentation In the Context of the "Total Mix" of Publicly Available Information.

Although predominantly a case-by-case determination not well suited for a bright-line rule, a plaintiff could attempt to ascertain materiality through (1) an analysis of the total mix of information available to the market; and/or (2) an empirical analysis of stock price movements in relation to publicly known facts known as an event study.[11]

In *Matrixx*, the Court refused to adopt a bright-line rule that pharmaceutical product risks should be

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[11] "An event study is a statistical analysis that isolates the effects of an event on a security's price and measures the likelihood that the effect could have been due to the normal random fluctuations of the security's price as opposed to being due to a particular event." Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 468 (2005); Glenn V. Henderson, Jr., *Problems and Solutions in Conducting Event Studies*, 57 J. RISK & INS. 282 (1990). "[T]he primary interest of investors is economic. After all, the principal, if not the only reason why people invest their money in securities is to obtain a return. A variety of other motives are probably present in the investment decisions of numerous investors but the only common thread is the hope for a satisfactory return, and it is to this that a disclosure scheme intended to be useful to all must be primarily addressed." Richard C. Sauer, *The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws*, 62 BUS. LAW. 317, 331-32 (2007) (citing SEC Release, Proposed Environmental Disclosures, 40 Fed. Reg. 51656, 51664 (Nov. 6, 1975) (alteration in original).

required to be disclosed as "material" only if such risks were "statistically significant." 131 S. Ct. at 1318-20. *Matrixx* reaffirmed *Basic*, holding that materiality is a test of "whether a reasonable investor would have viewed the nondisclosed information as having significantly altered the total mix of information made available." *Matrixx*, 131 S. Ct. at 1318, 1321 (quoting *Basic*, 485 U.S. at 232) (internal quotation marks omitted) (finding that "something more" is required to show that an omitted statement would have significantly altered the total mix of information).

For example, plaintiffs could seek to establish materiality at class certification by assessing an alleged misstatement in the context of the "total mix" of public information present at the time of the alleged misstatement. In this way, a plaintiff could attempt to show that a reasonable investor would have viewed the nondisclosed information as having significantly altered the "total mix" of information made available.

Materiality hinges upon the information that is publicly available to a reasonable investor. *See Basic*, 485 U.S. at 232; *Matrixx*, 131 S. Ct. at 1321. The plaintiff has access to this information – it is public by definition – and may readily assess the total mix of public information to present facts that establish the materiality of a particular statement within a particular timeframe. *See In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) ("In the context of an 'efficient' market, the concept of materiality translates into information that alters the price of the firm's stock."); *Shaw v. Digital Equipment*

Corp., 82 F.3d 1194, 1218 (1st Cir. 1996) (in cases involving the fraud-on-the-market theory of liability, statements identified as actionably misleading are alleged to have caused injury, "not through the plaintiffs' direct reliance upon them, but by dint of the statements' inflating *effect on the market price of the security purchased.*") (emphasis added), *superseded on other grounds by statute as recognized in Greebel v. FTP Software, Inc.*, 194 F.3d 185, 197 (1st Cir. 1999).

There are numerous ways that a plaintiff could seek to assess and analyze the total mix of information. Depending on the circumstances of the case, for example, review of press reports, company disclosures, or other publicly available information can be effective. Such methods are commonly used by plaintiffs. *In re Sadia, S.A. Sec. Litig.*, 269 F.R.D. 298, 317 (S.D.N.Y. 2010) (analysis of SEC filings and company conference calls); *Durgin v. Mon*, 659 F. Supp. 2d 1240, 1245 (S.D. Fla. 2009) (analysis of SEC filings and press release), *aff'd*, 415 F. App'x 161 (11th Cir. 2011); *Miller v. Lazard, Ltd.*, 473 F. Supp. 2d 571, 578 (S.D.N.Y. 2007) (analysis of news articles, press releases, and analyst reports); *see also In re Amgen Sec. Litig.*, 07-cv-02536-PSG-PLA, Dkt. No. 137, Order Regarding Motion to Dismiss (filed Feb. 1, 2008) (analysis of company conference calls); *DeMarco v. Lehman Bros., Inc.*, 222 F.R.D. 243, 246 (S.D.N.Y. 2004) (the "role of research analysts and other market professionals is, indeed, critical to the pricing mechanism of the securities market, for ordinary investors frequently lack sufficient expertise to interpret the wealth of information, much of it

highly technical, emanating from most public companies.").

Analyst reports can also provide useful insight into the total mix. *See, e.g.*, *Cal. Pub. Employees' Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 169 (3d Cir. 2004) (considering analysts' reports as part of the "total mix" of information available to a reasonable shareholder deciding how to vote). As reflected in the record in this case, analyst reports are often a useful reflection of public information and are readily available to the parties in securities cases.

It is reasonable to require securities fraud class action plaintiffs – who are typically represented by highly sophisticated counsel – to analyze information that is publicly available. To the extent a party may seek non-public information, a court can readily permit narrow precertification discovery. *See Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 351 n.13 (1978) ("discovery often has been used to illuminate issues upon which a district court must pass in deciding whether a suit should proceed as a class action under Rule 23 . . ."); *Stewart v. Winter*, 669 F.2d. 328, 331 (5th Cir. 1982) (quoting *Pittman v. E.I. duPont de Nemours & Co.*, 552 F.2d 149, 150 (5th Cir. 1977)) ("in most cases, 'a certain amount of discovery is essential in order to determine the class action issue and the proper scope of the class action.'").

At a minimum, a defendant should be permitted the opportunity to present evidence that might refute the claimed materiality of a particular statement

when analyzed in the total mix of information, as Petitioners sought to do in this case.

C. Materiality May Also be Established Through an Event Study of the Impact of an Alleged Misrepresentation on the Price of the Security

1. A Determination of the Impact of a Purported Misstatement on the Price of a Security Is Distinct From Loss Causation

In addition to an analysis of the total mix of information, a plaintiff can also use an economic analysis of "price impact" to establish the materiality.

It is important at the outset to distinguish *allowing* a showing of *price impact* at class certification to prove the materiality predicate from *requiring* a showing of *loss causation* at class certification. In *Halliburton*, this Court held that a plaintiff in a Section 10(b) case seeking class certification need not prove facts demonstrating *loss causation*. *Halliburton*, 131 S. Ct. at 2184. Loss causation tests the causation of any *damages* in securities cases. *See Dura Pharm., Inc.*, 544 U.S. at 342 (loss causation is "causal connection between the material misrepresentation and the loss"). Under *Dura*, a loss is actionable only if the revelation of the truth of a misrepresentation or omission results in a corresponding decline in stock price producing a quantifiable out-of-pocket loss. *Id.* at 346-47. That is, loss causation focuses on the movement of the stock price *after* revelation of the truth.

Price impact is a distinct concept from *loss causation*. In *Halliburton*, this Court articulated that reliance concerns "facts surrounding the investor's decision to engage in the transaction." 131 S. Ct. at 2186. Under *Basic*, "an investor presumptively relies on a defendant's misrepresentation if that 'information is reflected in [the] market price' of the stock at the time of the relevant transaction." *Halliburton*, 131 S. Ct. at 2186 (quoting *Basic*, 485 U.S. at 247). "Loss causation, by contrast, requires a plaintiff to show that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss." *Id.*

"'Price impact' simply refers to the effect of a misrepresentation on a stock price." *Id.* at 2187. Unlike loss causation, price impact is a means of establishing reliance, because it ultimately concerns analysis of the market price of stock at the time of the relevant transaction (*i.e.*, the purchase or sale relevant to a particular plaintiff's claim).[12] Several

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[12] As noted in Petitioners' brief, *see* Pet'rs Br. at 14, reliance or "but for" causation is wholly distinct from loss causation. "Reliance is an 'essential' component of a 10b-5 claim because it guarantees 'the "requisite causal connection between a defendant's misrepresentation and a plaintiff's injury."'" *Id.* (quoting *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008)). Market impact analysis similarly can address both price impact at purchase (*i.e.*, reliance) and loss causation (*i.e.*, damages). "Market-impact analysis takes two related forms: first, the showing that the market was distorted by the fraud; second, that the emergence of the truth, corrective disclosure, caused a loss to some or all investors. The former, as just noted, is what *Basic* focused on as a predicate for the presumption of reliance. The latter, loss causation, is conceptually distinct." Donald C. Langevoort,

circuits have found price impact to be an appropriate means of proving or disproving materiality at class certification. *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 485 (2d Cir. 2008); *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 634 (3d Cir. 2011); *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 265 (5th Cir. 2007), *abrogated on other grounds by Halliburton*, 131 S. Ct. 2179.

Price impact exists when a misrepresentation has distorted the market price of a security, so that *at the time of the purchase or sale* a misrepresentation affected the price of a security by a statistically significant amount. Price impact can evince materiality because only material misrepresentations will have a distorting impact on the price of a security. If a misrepresentation does not distort the market price, then the *Basic* reliance presumption simply does not apply. *See Halliburton*, 131 S. Ct. at 2186.

2. An Empirical Analysis of Materiality at Class Certification Is Practical, Proper, and Not Unduly Burdensome

An event study is a commonly used means of empirically assessing the predominance requirement under Rule 23 and the materiality element to the fraud-on-the-market presumption.[13] A plaintiff

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Basic at Twenty: Rethinking Fraud on the Market, 2009 WIS. L. REV. 151, 180 (2009).

[13] *See Eckstein v. Balcor Film Investors*, 58 F.3d 1162, 1170 (7th Cir. 1995) ("Reliance is the confluence of materiality and

likewise has readily available means to establish price impact at class certification through an event study because it requires empirical analysis of the total mix of publicly available information. *See* William O. Fisher, *Does the Efficient Market Theory Help Us Do Justice in A Time of Madness?*, 54 EMORY L.J. 843, 872 (2005).

Event studies use economic analysis to determine whether a particular alleged misstatement had a statistically meaningful impact on stock price. "[A]n event study . . . [can] determine whether the alleged misrepresentations caused any statistically significant stock price movements when made or when a supposedly corrective disclosure was made, controlling for other possible causes of stock price movements (such as movements of the overall market) and random fluctuations."[14] They "are commonly used to isolate the effects on the stock price of the disclosure of the withheld information."[15]

When an event study shows that a misrepresentation had a statistically significant effect on the price of a stock then, absent contrary evidence, the market may be presumed to have

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causation. The fraud-on-the-market doctrine is the best example; a material misstatement affects the security's price, which injures investors who did not know of the misstatement.").

[14] Daniel R. Fischel, *Market Evidence in Corporate Law*, 69 U. CHI. L. REV. 941, 948 (2002).

[15] Janet Cooper Alexander, *The Value of Bad News in Securities Class Actions*, 41 UCLA L. REV. 1421, 1433 (1994).

indirectly relied on the misrepresentation.[16] "And, by the fraud-on-the-market theory, all of the investors who bought (or sold) the stock also 'relied' by buying or selling at a market price that included a component reflecting the falsity."[17]

Federal courts have lauded the use of empirical studies in securities class action cases because the studies provide a useful metric for measuring the effect a particular statement has on the price of the stock.[18] *See, e.g., In re Zonagen, Inc. Sec. Litig.*, 322 F. Supp. 2d 764, 780 (S.D. Tex. 2003) (finding defendant's event study sufficiently rebutted the fraud-on-the-market presumption of reliance); *In re N. Telecom Ltd. Sec. Litig.*, 116 F. Supp. 2d 446, 460-61 (S.D.N.Y. 2000) (supporting use of event studies in

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[16] In addition to showing inflation at the time of purchase, a plaintiff could also use an event study to show a reaction to disclosure of the truth to establish materiality. *See In re SLM Corp. Sec. Litig.*, No. 08 CIV. 1029 WHP, 2012 WL 209095, at *5 (S.D.N.Y. Jan. 24, 2012) ("While not required at the class certification stage, evidence of a stock price movement following corrective disclosures may be a relevant factor in the legal assessment of materiality.") (citing *Berks Cnty. Emp. Retirement Fund v. First Am. Corp.*, 734 F. Supp. 2d 533, 540 n. 40 (S.D.N.Y. 2010)). By *allowing* a plaintiff to make such a showing of price movement (or allowing a defendant to show a lack of price movement) the Court would not be *requiring* a plaintiff to make such a showing.

[17] *See* William O. Fisher, *Does the Efficient Market Theory Help Us Do Justice in A Time of Madness?*, 54 EMORY L.J. at 874.

[18] *See* Michael J. Kaufman & John M. Wunderlich, *Regressing: The Troubling Dispositive Role of Event Studies in Securities Fraud Litigation.*, 15 STAN. J.L. BUS. & FIN. 183, 219 (2009) (acknowledging that federal courts have widely accepted the use of event studies).

securities actions); *In re Oracle Sec. Litig.*, 829 F. Supp. 1176, 1181 (N.D. Cal. 1993) (same); *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, 546 F.3d 196, 207-10 (2d Cir. 2008) (acknowledging importance of event studies in establishing market efficiency); *In re Xcelera.com Sec. Litig.*, 430 F.3d 503, 512-14 (1st Cir. 2005) (same); *In re Nature's Sunshine Prods. Inc. Sec. Litig.*, 251 F.R.D. 656, 664-65 (D. Utah 2008) (same); *see also* Frederick C. Dunbar, et al, *Fraud on the Market Meets Behavioral Finance*, 31 Del. J. CORP. L. at 468 (event studies are frequently determined by courts to be necessary tools to assess the price impact of a particular statement).

In fact, plaintiffs in this case conducted an event study related to the efficiency of the market to establish that particular *Basic* predicate for class certification.[19] Simply stated: an event study conducted to establish materiality in a securities fraud case can empirically assess whether a purported misstatement affected the market price of the security in order for the court to presume reliance under the fraud-on-the-market theory.[20]

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[19] *See* Mem. of Points and Authorities in Support of Lead Pl.'s Mot. for Class Cert. at 17, *Conn. Ret. Plans & Trust Fund v. Amgen Inc.* (C.D. Cal. Mar. 4, 2009), No. CV 07-2536 PSG (PLAx), ECF No. 129.

[20] William O. Fisher, *Does the Efficient Market Theory Help Us Do Justice in A Time of Madness?*, 54 EMORY L.J. at 871 (event studies are employed to determine, among other elements in a 10b-5 action, whether a purported misstatement was or was not material).

Absent a statistically significant impact on price at the time of the purported misstatement, one of two truths is revealed: (1) the alleged misstatement is not material; or (2) the statement is material, but the market is not efficient. The failing of either requires the trial court to deny certification because the plaintiff cannot establish the necessary foundation required to invoke the fraud-on-the-market presumption.[21]

In addition to an analysis of the total mix of information, then, a plaintiff could attempt to establish materiality through an event study at class certification. Such an empirical analysis of the purported misstatement and its impact upon the price of the security is therefore practical, not unduly burdensome, and usually effective in providing a metric to ascertain materiality. For example, in this matter, respondent presented the trial court with an empirical analysis of the efficiency of the market at class certification.

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[21] *See In re DVI, Inc. Sec. Litig.*, 639 F.3d at 638 (finding that in an otherwise efficient market, the failure of a corrective disclosure to affect the market price may serve as a rebuttal to the presumption of reliance because it renders the misstatement immaterial as a matter of law); *In re Moody's Corp. Sec. Litig.*, 274 F.R.D. 480, 493 (S.D.N.Y. 2011) (finding "no period within the proposed class period where the alleged misrepresentation caused a statistically significant increase in the price or where a corrective disclosure caused a statistically significant decline in the price . . . . the reliance presumption for . . . the class cannot be certified"); *In re Am. Int'l Grp., Inc. Sec. Litig.*, 265 F.R.D. 157, 182, (S.D.N.Y. 2010); *In re Credit Suisse First Boston Corp. (Lantronix, Inc.) Analyst Sec. Litig.*, 250 F.R.D. 137, 143-49 (S.D.N.Y. 2008) (analyzing significance of market responses to statements and disclosures at the beginning, middle, and end of the class period).

IV. AT A MINIMUM, COURTS SHOULD ALLOW A DEFENDANT THE OPPORTUNITY TO REBUT THE FRAUD-ON-THE-MARKET PRESUMPTION BY REFUTING MATERIALITY AT CLASS CERTIFICATION

Under *Basic*, the fundamental premise in crafting a presumption of reliance to permit securities actions to be litigated as class actions was that a defendant be afforded the opportunity to rebut the presumption with "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price . . . ." 485 U.S. at 248; *see also In re DVI, Inc. Sec. Litig.*, 639 F.3d at 632 (finding defendants may rebut the presumption of reliance with any defense to actual reliance); *Semerenko v. Cendant Corp.*, 223 F.3d 165, 178-79 (3d Cir. 2000) (the fraud-on-the-market doctrine merely creates a presumption which a defendant may rebut by raising any defense to actual reliance); *In re Salomon*, 544 F.3d at 485 (court must permit defendants to present rebuttal arguments before certifying a class). *Basic* delineated a non-exhaustive list of potential defenses that would sever the link required to invoke the fraud-on-the-market presumption and specifically mentioned a showing that the alleged misstatement was immaterial.[22]

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[22] *See Basic*, 485 U.S. at 248-49 ("For example, if petitioners could show that the 'market makers' were privy to the truth about the merger discussion here with Combustion, and thus that the market price would not have been affected by their

Permitting a defendant to rebut the fraud-on-the-market presumption is also necessary so district courts can determine a proper class period (and typicality). As a simple hypothetical example, assume a plaintiff asserts a 2-year class period in a case in which a company on day one allegedly misrepresents its financial results (*e.g.* net income); announces an intent to restate on day 200; actually details its restatement and corrects its results on day 400; the stock drops ten percent on day 401; and the stock then drops (on no announcements) another ten percent on day 730 (the end of the two years). Without considering whether the restatement announcement or the actual restatement corrected the alleged material misrepresentation (*i.e.*, whether the material truth had been revealed so that any inference of reliance on market price has been severed), the court cannot determine when the class should properly end.[23]

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misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone. Similarly, if, despite petitioners' allegedly fraudulent attempt to manipulate market price, news of the merger discussions credibly entered the market and dissipated the effects of the misstatements, those who traded Basic shares after the corrective statements would have no direct or indirect connection with the fraud. Petitioners also could rebut the presumption of reliance as to plaintiffs who would have divested themselves of their Basic shares without relying on the integrity of the market.").

[23] In this example, the class period should obviously end before the second ten percent drop. Not allowing a defendant to rebut the presumption and allowing a two-year class period rather than a proper, shorter period almost *doubles* the amount of alleged class damages.

Requiring a case to proceed as a class action, notwithstanding the availability of dispositive evidence refuting a claim of materiality, would unnecessarily increase the costs of defending meritless litigation and the possibility of *in terrorem* settlements. For this reason, the Court should affirm a defendant's right to refute a claim of materiality at class certification.

CONCLUSION

For all the foregoing reasons, the Court should reverse the Ninth Circuit's opinion.

Respectfully submitted,

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August 15, 2012

AMICUS CURIAE BRIEF

RECORD
AND
BRIEFS

No. 11-1085

IN THE

Supreme Court of the United States

AMGEN INC., KEVIN W. SHARER, RICHARD D. NANULA, ROGER M. PERLMUTTER, & GEORGE J. MURROW,

Petitioners,

v.

CONNECTICUT RETIREMENT PLANS & TRUST FUNDS,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF WASHINGTON LEGAL FOUNDATION AND ALLIED EDUCATIONAL FOUNDATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Amici curiae address the following issues:

1. Whether, in a misrepresentation case under SEC Rule 10b-5, the district court must require proof of materiality before certifying a class based on a fraud-on-the-market theory.

2. Whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

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INTERESTS OF *AMICI CURIAE*[1]

The Washington Legal Foundation (WLF) is a public-interest, law and policy center with supporters in all 50 states. WLF regularly appears before federal and state courts to promote economic liberty, free enterprise, and a limited and accountable government. To that end, WLF routinely litigates in cases concerning the proper scope of the federal securities laws. *See, e.g., Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011); *Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869 (2010); *Stoneridge Inv. Partners, LLC v. Scientific Atlanta, Inc.*, 552 U.S. 148 (2008). WLF has also participated extensively in litigation in support of its view that federal courts should not certify cases as class actions unless the plaintiffs can demonstrate that they have satisfied each of the requirements of Rule 23 of the Federal Rules of Civil Procedure. *See, e.g., Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011).

The Allied Educational Foundation (AEF) is a non-profit charitable foundation based in Englewood, New Jersey. Founded in 1964, AEF is dedicated to promoting education in diverse areas of study, such as law and public policy, and has appeared in this Court on a number of occasions.

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[1] Pursuant to Supreme Court Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part; and that no person or entity, other than *amici* and their counsel, made a monetary contribution intended to fund the preparation and submission of this brief. All parties to this dispute have consented to the filing of this brief, and letters of consent have been lodged with the Court.

Amici are deeply concerned by the proliferation of class action lawsuits being filed throughout the federal court system—especially lawsuits alleging securities fraud—and the inhibiting effect that such litigation can have on the development and expansion of business. *Amici* believe that the district court's certification decision, if allowed to stand, will only exacerbate that trend by encouraging efforts to certify inappropriate, unwieldy classes. Because the decision to certify a class is so often outcome determinative, class action defendants should be free at the certification stage to present evidence rebutting the presumption of reliance.

STATEMENT OF THE CASE

Respondent Connecticut Retirements Plans and Trust Funds alleges that Petitioners (collectively, "Amgen") violated federal securities laws by issuing misleading information (and omitting material information) regarding two of Amgen's biologics. Respondent alleges that Amgen's violations caused it to purchase Amgen stock at an artificially inflated price, resulting in significant losses.

Relying on the fraud-on-the-market theory, Respondent sought certification of a plaintiff class comprising all those who purchased Amgen stock between April 22, 2004 (the date of Amgen's first alleged misrepresentation) and May 10, 2007 (the date on which the truth allegedly was fully disclosed). Respondent argued that the court could simply presume that members of the proposed class relied on Amgen's alleged misrepresentations—

regardless whether they ever heard the misrepresentations—because the stock traded on the open market. As a result, Respondent argued, the price paid for the stock likely included a premium reflecting the market's awareness of and reliance on the alleged misrepresentations.

The district court granted the certification motion in August 2009, finding that Respondent satisfied the prerequisites of Fed. R. Civ. P. 23(a) and 23(b)(3). Pet. App. 15a-50a. In particular, the court determined that Respondent met Rule 23(b)(3)'s "predominance" requirement because—based on the fraud-on-the-market theory of liability—Respondent was entitled to a presumption that all class members relied on Amgen's alleged misrepresentations. *Id.* at 31a-40a. It stated that Respondent was entitled to that presumption because Respondent had established that class members purchased their securities on an "efficient market." *Id.* at 40a. It explained, "the Court agrees with Plaintiff that to trigger the presumption of reliance, Plaintiff need only establish that an efficient market exists. Other inquiries into issues such as materiality and loss causation are properly taken up at a later stage in this proceeding." *Id.*

The court further held that Amgen would not be given an opportunity at the certification stage to rebut the presumption by attempting to demonstrate that "the truth" was known to the market throughout all or most of the class period. *Id.* at 40a-44a. Rather, the court held that a party opposing class certification is not permitted to have its rebuttal evidence considered until the summary judgment stage. *Id.* at 44a. The court reasoned that

if it were to allow Amgen "to present evidence that none of the investors were misled because the truth was on the market, the Court would essentially be allowing [Amgen] to assert a defense of non-reliance as a basis for denial of class certification. But such is not allowed." *Id.*

On appeal, the U.S. Court of Appeals for the Ninth Circuit affirmed. *Id.* at 1a-13a. The panel held that a fraud-on-the-market presumption attaches if a plaintiff can merely demonstrate "whether the securities market was efficient and whether the defendant's purported falsehoods were public." *Id.* at 9a. The appeals court rejected arguments that the availability of the presumption hinged on proving that the alleged misstatements were material, *i.e.*, that the market was actually misled by and relied on the misstatements. *Id.* at 12a. Concluding that materiality is a "merits" question inappropriate for consideration at the class certification stage, the court explained that "the plaintiff must plausibly allege—but need not *prove* at this juncture—that the claimed misrepresentations were material." *Id.* at 2a, 8a-9a. The court further held that any effort by defendants to rebut materiality was always premature at the class certification stage; rather such evidence may be offered only at trial or "by summary judgment motion if the facts are uncontested." *Id.* at 12a-13a.

SUMMARY OF ARGUMENT

In affirming class certification, the Ninth Circuit adopted an alarmingly narrow view among the federal appeals courts regarding what must be shown to satisfy Fed. R. Civ. P. 23(b)(3)'s predominance requirement in a securities law class action. The court held that certification is required under a fraud-on-the-market theory whenever the plaintiff demonstrates that the securities market was efficient and that the defendant's alleged falsehoods were public. So long as those perfunctory showings are made, under the Ninth Circuit's view, it is irrelevant how much evidence exists showing that the alleged falsehoods were not deemed material by the market—the class must be certified.

The shortcomings of this rule are obvious: because the market for the common stock of virtually every major corporation is likely to be "efficient" (especially as that concept has been simplistically applied in the lower federal courts), all but the dullest plaintiffs' lawyer will always be able to win class certification. All that is necessary is to point to some public statement of the corporate defendant and allege that the statement was misleading and caused stock prices to be artificially inflated. Once the shareholder class is certified, public corporations face overwhelming pressures to settle even the most insubstantial or frivolous claims.

The decision below flies in the face of this Court's binding precedent. The Court first addressed the fraud-on-the-market theory in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). Acknowledging that the theory supported application of a "rebuttable presumption of reliance"

when a plaintiff makes the requisite showings, the Court concluded that "[i]t is not inappropriate" for a district court to apply the presumption, subject to rebuttal. 485 U.S. at 250. Contrary to the Ninth Circuit, *Basic* never suggested that a defendant's rebuttal must be deferred to trial. And only last year, the Court reiterated a defendant's right to rebuttal and explicitly conditioned any presumption of investor reliance on a finding that the defendant's misrepresentation is actually "reflected in the market price at the time of [the investor's] transaction." *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2185-86 (2011). Of course, a misrepresentation that is not "material" will never be reflected in the market price. But the Ninth Circuit's flawed approach to class certification completely ignores this crucial distinction.

Indeed, a key factor in determining whether the plaintiff is entitled to a presumption of reliance is "the time the truth was revealed." This was the precise issue on which Amgen sought to be permitted to introduce important rebuttal evidence below. Its consistent position throughout this litigation has been that "the time the truth was revealed" occurred on or before the time it made its alleged misrepresentations. Accordingly, the Ninth Circuit's determination that Amgen could not be allowed to introduce important rebuttal evidence at the class certification stage simply cannot be harmonized with this Court's statements in *Erica P. John Fund*.

The Ninth's Circuit's approach also fails to appreciate the crucial role that certification decisions play in the outcome of high-stakes securities class-action litigation. Empirical research demonstrates

that litigation costs make it very difficult for the party that loses the class certification decision to continue with the litigation—with the result that erroneous certification decisions are effectively unreviewable. In light of that concern, this Court should adopt a clear rule that will encourage district judges to grant certification motions only after determining that *all* the requirements of Rule 23 have been satisfied.

ARGUMENT

I. THE DECISION BELOW UNDERMINES THIS COURT'S CLEAR PRECEDENT ON THE PRESUMPTION OF RELIANCE

Respondent claims the right to sue Amgen not only on its own behalf but also as a representative of the thousands of others who purchased Amgen stock during a three-year period beginning in April 2004. Fed. R. Civ. P. 23 imposes numerous requirements on those seeking to maintain such a representative action, including (under the circumstances of this case) a judicial finding "that the questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). Certification of a class is appropriate only if "the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied." *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551 (2011) (quoting *Gen. Tel. Co. S.W. v. Falcon*, 457 U.S. 147, 161 (1982)).

To prevail in a securities fraud action, a plaintiff must demonstrate, *inter alia*, actual *reliance* on the defendant's misrepresentation. *Dura*

Pharms v. Broudo, 544 U.S. 336, 341-42 (2005). Thus, to satisfy Rule 23(b)(s)'s predominance requirement, a plaintiff must demonstrate that reliance can be established on a class-wide basis, because if reliance can only be established on a plaintiff-by-plaintiff basis, questions of law or fact common to class members could never "predominate" over questions affecting only individual members. *See Basic*, 485 U.S. at 242. As a result, whether Respondent is entitled to a presumption of reliance is very much a Rule 23(b)(3) class certification issue, because Respondent cannot possibly satisfy the "predominance" requirements (and thus is not entitled to certification) unless it is afforded that presumption.

A. *Basic* and *Erica P. John Fund* Establish That Evidence Rebutting the Presumption of Reliance Is Not Premature at the Class Certification Stage

This Court's opinion in *Basic, Inc. v. Levinson* endorsed the "general validity" of the fraud-on-the-market theory and held that, under appropriate circumstances, the theory supports recognition of a presumption of reliance in securities fraud cases. 485 U.S. at 242. The Court described the theory as follows:

> The fraud on the market theory is based on the hypothesis that, in an open and developed market, the price of a company's stock is determined by the available information regarding the company and its business. . . . Misleading statements will

> therefore defraud purchasers of stock even if the purchasers of stock do not directly rely on the misstatements. . . . The casual connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.

Id. at 241-42 (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986)).

The Court determined that (1) "it is not inappropriate to apply a presumption of reliance supported by the fraud-on-the-market theory"; (2) that presumption is "rebuttable"; and (3) the district court's initial certification of the class "was appropriate when made but is subject on remand to such adjustment, if any, as developing circumstances demand." *Id.* at 250. Although the Court upheld the trial court's class certification decision, nothing in the Court's summation of its holding even remotely suggests that a defendant's efforts to rebut the presumption of reliance are premature at the class certification stage.

Indeed, numerous passages in the decision point in the opposite direction. On several occasions, in connection with its ruling that the presumption of reliance was rebuttable, *Basic* emphasized that a class certification order is subject to revision at all times prior to final judgment. *See, e.g., id.* at 250 (emphasizing that class certification is subject on remand to adjustments "as developing circumstances demand"). Those passages show that the Court contemplated that defendants should *not* be required to wait for a bull blown trial before attempting to

rebut the presumption of reliance.

In contrast, the panel below held that it is "premature" for a defendant seeking to demonstrate a lack of preponderance to try to rebut the presumption of reliance at the class certification stage by introducing evidence that the allegedly misleading statements were immaterial and thus never relied on by the market. *See* Pet. App. 12a-13a. Rather, the appeals court held, such rebuttal evidence may only be presented at trial. *Id.* That holding is in significant tension with the passages from *Basic* cited above.

The Ninth Circuit's rejection of Amgen's efforts to raise a truth-on-the-market defense is particularly problematic. While conceding that a truth-on-the-market defense negates a stock fraud claim by demonstrating that the market was fully aware of Amgen's financial condition and thus that the market price was unaffected by any misrepresentation, the appeals court inexplicably concluded that such evidence is merely "a method of refuting an alleged misrepresentation's materiality" and thus may not be introduced to defeat class certification. *Id.* at 13a.

Properly understood, however, the truth-on-the-market theory is both a defense on the merits *and* a perfectly appropriate basis for rebutting the presumption of reliance. As such, it is also highly relevant in determining whether the Rule 23 requirements have been satisfied. The truth–on-the-market theory postulates that a misrepresentation cannot possibly have a fraudulent effect on a stock's value after information contrary to the

misrepresentation becomes known to an efficient market. It posits that the market will naturally not rely on a defendant's allegedly misleading information if the "truth" is widely disseminated during the class period and is thus known to the market. *See, e.g., Ganino v. Citizens Utility Co.*, 228 F.3d 154, 167 (2d Cir. 2000).

That is why this Court has included truth-on-the-market as one of the theories a securities law defendant may deploy to rebut the presumption of reliance in a fraud-on-the-market case:

> Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance. For example, if petitioners could show that the "market makers" were privy to the truth about [the alleged misrepresentations] and thus that the market price would not have been affected by their misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone.

Basic, 485 U.S. at 248. It would have made little sense for the Court to discuss truth-on-the-market in connection with efforts "to rebut the presumption of reliance" if it truly contemplated (as the Ninth Circuit held) that any such rebuttal must be forsworn until trial. But if a securities law defendant must await trial for a rebuttal

opportunity, any trial victory would be of limited value; after all, a holding that rejects the presumption of reliance would result in decertification of the class for failure to meet Rule 23(b)(3)'s predominance requirement, not in a class-wide victory on the merits.

In concluding that materiality is not properly considered at the class certification stage, the appeals court relied in substantial part on its curious conclusion that a "no materiality" finding would defeat the claims of *every* shareholder. Pet. App. 8a. But that conclusion is belied by common sense. For even if the market as a whole did not rely on the alleged misrepresentations, it is entirely conceivable that individual shareholders did so. For example, they might have been unwilling to purchase shares at the market price *but for* their belief in the truth of misrepresentations. And if such shareholders can establish loss, there is no reason why they should not be permitted to proceed with their securities fraud claims on an individual basis.

Indeed, in its most recent opinion regarding fraud-on-the-market claims, this Court explicitly contemplated the propriety of such individual suits:

> Reliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) cause of action. . . . The traditional (and most direct) way a plaintiff can demonstrate reliance is by showing that he was aware of a company's statement and engaged in a relevant transaction, *e.g.*, purchasing common stock—based on that specific

> representation. In that situation, the plaintiff plainly would have relied on the company's deceptive conduct.

Erica P. John Fund, 131 S. Ct. at 2184-85. Contrary to the Ninth Circuit's analysis, then, a "no materiality" finding for the entire class would in no way defeat the claims of *every* shareholder.

It would be patently unfair to those shareholders who actually relied on the alleged misrepresentation to force them to be bound by a fraud-on-the-market class action, particularly where there is serious doubt that "the market" also relied on the misrepresentation. *See Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 811-12 (1985). By allowing rebuttal evidence on materiality to be introduced at the class certification stage, courts can protect individual shareholders who might otherwise have their rights cut off if a class were certified in a fraud-on-the-market case in which "the market" did not deem the misrepresentations to be material (in which case, the class is destined for eventual defeat).

The panel below cited *Erica P. John Fund* in support of its contention that a plaintiff need make only two showings to be entitled to class certification: an efficient market and public representations. Pet. App. 11a. But, contrary to the Ninth Circuit's characterization, *Erica P. John Fund* squarely imposes *at least three* requirements on securities fraud plaintiffs seeking to obtain class certification:

> It is undisputed that securities fraud plaintiffs must prove certain things in order

> to invoke *Basic*'s rebuttable presumption. It is common ground, for example, that plaintiffs must demonstrate that the alleged misrepresentations were publicly known (else how would the market take them into account?), that the stock traded in an efficient market, and that *the relevant transaction took place "between the time the misrepresentations were made and the time the truth was revealed."*

Erica P. John Fund, 131 S. Ct. at 2185 (quoting *Basic*, 485 U.S. at 248 n.27) (emphasis added).[2]

This Court, therefore, has already established that a key factor in determining whether the plaintiff is entitled to a presumption of reliance is "the time the truth was revealed." This was the precise issue on which Amgen sought to be permitted to introduce important rebuttal evidence below. Its consistent position throughout this litigation has been that "the time the truth was revealed" occurred on or before the time it made its alleged misrepresentations. The Ninth Circuit's determination that Amgen could not be allowed to

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[2] Footnote 27 of *Basic* sets forth the requirements that a plaintiff must meet in order to invoke the presumption of reliance. In an effort to side step these requirements, the Ninth Circuit insists that Footnote 27 was merely reciting the requirements listed by the Sixth Circuit, whose opinion was under review. Pet. App. 11a. But that explanation cannot possibly be squared with this Court's returning to that exact same footnote in *Erica P. John Fund* to support the proposition that there are at least three well-established requirements that must be met to invoke the presumption of reliance.

introduce important rebuttal evidence at the class certification stage simply cannot be harmonized with this Court's statements in *Erica P. John Fund*.

B. The Decision Below Ignores *Wal-Mart*'s Admonition That Courts Should Not Avoid Addressing Issues Relevant to Class Certification Simply Because They Are Also Merits-Based Issues

The appeals court held that, for purposes of class certification, Rule 23 requires only that a plaintiff adequately plead materiality—it need not introduce supporting evidence. Pet. App. 2a. ("As for the element of materiality, the plaintiff must plausibly allege—but need not prove at this juncture—that the claimed misrepresentation was material."). But this Court has already rejected that view in *Wal-Mart v. Dukes*, holding that "Rule 23 does not set forth a mere pleading standard." 131 S. Ct. at 2551. Rather, a "party seeking class certification must affirmatively demonstrate his compliance with the Rule—that is, he must be prepared to prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc." *Id.* (emphasis in original). As a result, courts are required to resolve any "merits question[s]" bearing on class certification, even if the plaintiffs "will surely have to prove [those issues] *again* at trial in order to make out their case on the merits." *Id.* at 2552 n.6.

The Ninth Circuit attempted to support its decision not to require proof of materiality at the class certification stage with the fact that

"materiality is an element of the *merits* of their securities fraud claim." Pet. App. 8a (emphasis in original). Under this view,

> the plaintiffs cannot fail to prove materiality yet still have a viable claim for which they would need to prove reliance individually. *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341 (2005). If the misrepresentations turn out to be material, then the fraud-on-the-market presumption makes the reliance issue common to the class, and class treatment is appropriate. But if the representations turn out to be immaterial, then *every* plaintiff's claim fails on the merits (materiality being a standalone merits element), and there would be no need for a trial on each plaintiff's individual reliance. Either way, the plaintiffs' claims stand or fall together—the critical question in the Rule 23 inquiry.

Id. at 8a-9a (citing *Wal-Mart*) (emphasis in original). In the court's view, because materiality was a common question of fact and could be determined on a class-wide basis, its resolution must await a full-blown trial on the merits.

But the Ninth Circuit's analysis is based on a serious misreading of *Wal-Mart* and ignores this Court's holding in that decision. *Wal-Mart* repeatedly emphasized that the trial courts should *not* shy away from delving into issues that touch on the merits of the lawsuit if doing so is necessary to determine whether class certification is appropriate

under Rule 23. This Court called on district courts to engage in a "rigorous analysis" to determine whether the prerequisites of Rule 23 have been satisfied, and added:

> Frequently the "rigorous analysis" will entail some overlap with the merits of the plaintiff's underlying claim. That cannot be helped. "[T]he class determination generally involves considerations that are enmeshed in the factual and legal issues comprising the plaintiff's cause of action." . . . Nor is there anything unusual about that consequence: The necessity of touching aspects of the merits in order to resolve preliminary matters, *e.g.*, jurisdiction and venue, is a familiar feature of litigation.

Wal-Mart, 131 S. Ct. at 2551-52 (quoting *Falcon*, 459 U.S. at 160).

Notwithstanding this Court's prior holdings, the Ninth Circuit's position that no issue capable of being resolved on a class-wide basis should be deferred until trial, even when the issue is relevant to class certification, has little to recommend it. Of course, it may sometimes be true that a defendant who rebuts the presumption of reliance defeats the plaintiffs' claims on the merits. But even the Ninth Circuit would surely concede that such a rebuttal also defeats a claim for class certification by demonstrating the absence of the predominance required by Rule 23(b)(3). Under such circumstances, what possible justification remains for allowing class certification to proceed? A court should not make it easier for a plaintiff to win

certification in those cases where the defendant has evidence demonstrating that the entire securities fraud claim is meritless. For that reason alone, this Court should reverse the decision of the Ninth Circuit.

C. The Decision Below Contravenes *Basic*'s Repeated Emphasis On the Need for Evidence to Establish the Starting and Ending Dates for the Class Period

Truth-on-the-market rebuttal evidence is particularly relevant in determining appropriate starting and ending dates for the class period. The district court included within the certified class all those who purchased Amgen stock between April 2004 and May 2007. Amgen asserts that the "truth" regarding its two biologics had entered the market by April 2004 and continued to enter the market throughout the unusually lengthy three-year class period certified in this case. By denying Amgen an opportunity to submit its rebuttal evidence, both the Ninth Circuit and the district court deprived themselves of crucial evidence regarding the dates, if any, on which the misleading information was affecting share prices and the dates when the "truth" effectively counterbalanced the allegedly misleading information. *See, e.g., In re Fed. Nat'l Mortg. Ass'n Sec., Derivatives, and "ERISA" Litig.*, 247 F.R.D. 32, 38 (D.D.C. 2008) ("[W]hether the fraud-on the-market presumption applies as a matter of law is essential for determining the duration of the class period.").

The panel below held that the *only* evidence

relevant to the class certification issue is whether the market for the stock was efficient and whether the alleged misrepresentations were public. But unless a trial court agrees to hear all evidence regarding when and if the "truth" reached the market, it cannot possibly ascertain when the class ought to begin and end. If Amgen's excluded evidence would have shown that truth on the market had eliminated the misrepresentations effects on market price by May 2004, there can be no justification for certifying a class that runs until May 2007 simply because the plaintiff has merely alleged—but has not been asked to prove—that it was only after May 2007 that the market became fully aware of the truth.

Similarly, if Amgen's evidence would have demonstrated that the truth was revealed by April 2004 (the same date on which Respondent alleges that the misrepresentations were first made), then there can be no justification for establishing any class period, and class certification should be denied. By mandating exclusion of all rebuttal evidence as to when the truth entered the market, the decision below deprives district courts of the ability to determine an appropriate class period.

That is inconsistent with this Court's approach to certification in securities class actions. Throughout its *Basic* decision, the Court exhibited a keen awareness of the need to limit the class period to the dates during which the defendant's misstatements were distorting market price. *See, e.g.*, 485 U.S. at 249 (clarifying that the presumption of reliance is rebutted, and thus class certification is inappropriate, with respect to those who trade the

defendant's shares after truthful information "credibly entered the market" and "dissipated the effects of the misstatements"). Indeed, the Court expressed skepticism that a "well-developed, efficient and information-hungry market" could remain misinformed—and thus mistake the value of the defendant's stock—throughout a 14-month class period as a result of a small number of statements by the defendant. *Id.* at 249 n.29. Yet Respondent asks this Court to believe that the market was mistaken about the value of Amgen stock throughout a class period that was almost three times as long (37 months). By preventing Amgen from introducing evidence that the class period is excessive because the market knew the "truth" for some or all of that period, the decision below brazenly contravenes this Court's decision in *Basic*. The decision below should be reversed.

II. BECAUSE CLASS CERTIFICATION DECISIONS ARE USUALLY OUTCOME DETERMINATIVE, CLASS ACTION DEFENDANTS SHOULD BE FREE TO REBUTT THE PRESUMPTION OF RELIANCE

Empirical research demonstrates the crucial role that class certification decisions play in the outcome of high-stakes class action lawsuits. Litigation costs make it very difficult for the party that loses the class certification decision to continue with the litigation—with the result that erroneous certification decisions are often effectively unreviewable. In light of that concern, *amici* respectfully urge the Court to adopt clear rules that will encourage district judges to certify plaintiff

classes only after they have determined that all the requirements of Rule 23 have been satisfied.

As numerous courts have recognized, companies that face a large certified class (and enormous potential damages) are "under intense pressure to settle." *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1298 (7th Cir.) (Posner, C.J.), *cert. denied*, 516 U.S. 867 (1995). Unless defendants want to "roll the dice," they must settle—often without regard to the merits of the plaintiffs' underlying claims. *Id.* In many instances, such settlements can legitimately be characterized as "blackmail settlements." Henry J. Friendly, *Federal Jurisdiction: A General View* 120 (1973). *See also* Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 99 (2009) ("With vanishingly rare exception, class certification sets the litigation on a path toward resolution by way of settlement, not full-fledged testing of the plaintiffs' case by trial.").

Securities fraud class action litigation presents particular problems for defendants because they are especially prone to asymmetrical discovery costs: though plaintiffs possess few relevant documents subject to discovery, they can routinely demand that millions of pages of documents be produced by the defendants. Janet Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497, 548-49, 571 (Feb. 1991). Moreover, because securities fraud cases often require the attention and participation of senior corporate executives, defendants in such actions can face costly and debilitating disruptions of their business activities.

Robert Bone & David Evans, *Class Certification and the Substantive Merits*, 51 Duke L.J. 1251, 1299 (Feb. 2002). Driven largely by litigation costs, "the vast majority of certified [securities fraud] class actions settle, most soon after certification." *Id.* at 1291. *See also* William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. Pa. L. Rev. 69 (2011); John C. Coffee Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534 (2006).

The tendency of securities fraud class actions to settle without regard to the underlying merits undermines the aim of federal securities law—to deter securities fraud or manipulation. But economists doubt that these laws can achieve their purpose given the consensus view that little if any correlation exists between being named in a securities fraud lawsuit and the actual incidence of fraud. *See, e.g.*, Marilyn Johnson, *et al.*, In re Silicon Graphics Inc.: *Shareholders Wealth Effects Resulting from the Interpretation of the Private Securities Litigation Reform Act's Pleading Standard*, 73 S. Cal. L. Rev. 773, 782 (May 2000).

Congress has recognized the severity of the problem and has adopted legislation designed to curb abusive securities law class actions. The Private Securities Litigation Reform Act of 1995 (PSLRA), 109 Stat. 737, adopted numerous reform measures, including a provision that imposed strict pleading requirements upon "any private action" arising from the Securities Exchange Act. *See* 15 U.S.C. § 78u-4(b). Congress enacted the PSLRA "as a check against abusive litigation by private parties."

Tellabs, Inc. v. Makor Issue & Rights, Ltd., 551 U.S. 308, 313 (2007). It recognized that private securities fraud actions, "if not adequately controlled, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law." *Id.* *See* H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.) (citing evidence of abuse, including "routine filing of lawsuits . . . whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of [the defendants]," and "abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized [defendant] to settle"). As this Court has previously recognized, "Proponents of the [PSLRA] argued that these abuses resulted in extortionate settlements, chilled any discussion of issuers' future prospects, and deterred qualified individuals from servicing on boards of directors." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006).

By certifying securities law class actions without regard to whether the defendants' alleged misrepresentations were material and thereby affected the market, lower federal courts are encouraging the sorts of abuses that the PSLRA has long sought to discourage. Unfortunately, these abuses will continue until this Court adopts a clear rule encouraging district judges to grant certification motions only after determining that *all* the requirements of Rule 23 have been satisfied.

CONCLUSION

For the foregoing reasons, *amici curiae* Washington Legal Foundation and Allied Educational Foundation respectfully request that the Court reverse the Ninth Circuit's holding below.

Respectfully submitted,

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